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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1939

No. 63

V. L. LETULLE, PETITIONER,

vs.

FRANK SCOFIELD, UNITED STATES COLLECTOR
OF INTERNAL REVENUE FOR THE FIRST DIS-
TRICT OF TEXAS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE FIFTH CIRCUIT.

PETITION FOR CERTIORARI FILED MAY 22, 1939.

CERTIORARI GRANTED OCTOBER 9, 1939.

SUPREME COURT OF THE UNITED STATES

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vs.

FRANK SCOFIELD, UNITED STATES COLLECTOR
OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS

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[fol. a]

[Captions omitted]

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**IN UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF TEXAS, AUSTIN DIVI-
SION**

No. 1412 at Law

V. L. LeTulle, Plaintiff,

vs.

FRANK SCOFIELD, United States Collector of Internal Revenue for The First District of Texas, Defendant

PLAINTIFF'S ORIGINAL PETITION—Filed Sept. 9, 1936

To the Honorable Judge of said Court:

Comes now V. L. LeTulle, a citizen of the State of Texas, hereinafter called plaintiff, and files this his original petition, complaining of Frank Scofield as Collector of Internal Revenue for the United States for the First District of Texas, hereinafter called defendant, and shows to the Court as follows:

I

Plaintiff is, and has been at the various dates hereinafter alleged, a citizen of the State of Texas residing in Bay City, Matagorda County, Texas.

II

Defendant is, and was on the various dates hereinafter alleged, the duly appointed, qualified and acting United States Collector of Internal Revenue for the First District of Texas, which district includes Matagorda County, Texas, and as such Collector he was invested with the power and authority to collect taxes upon the income of persons and corporations within said district that were levied and assessed under and by virtue of the Act of Congress designated as the Revenue Act of 1928. The residence of the defendant is at Austin, Travis County, Texas.

III

Plaintiff's cause of action is to recover from the defendant the amounts of income taxes and interest paid by the plaintiff as Transferee of the assets of Gulf Coast Irrigation Company, a Texas corporation, to the defendant for the fiscal year beginning April 1, 1930, and ended March 31, 1931, and for the fiscal period beginning April 1, 1931, and ended November 21, 1931, with legal interest thereon from the dates of their payments that plaintiff alleges were wrongfully, illegally and without authority of law collected from the plaintiff by the defendant, all as set forth hereinafter in detail. On or about November 24, 1931, Gulf Coast Irrigation Company was dissolved and ceased to be a corporation and its assets were distributed to plaintiff as the sole stockholder of said corporation. Thereafter during the year 1934, the Commissioner of Internal Revenue of the United States assessed and collected from the plaintiff as Transferee of the assets of said corporation the income taxes hereinafter set forth, which income taxes were assessed on account of the alleged income of the corporation during said fiscal year and fiscal period.

IV

Under and by virtue of the provisions of the Revenue Act of 1928 and the rules and regulations prescribed by the Commissioner of Internal Revenue and the Secretary of the Treasury in connection therewith, Gulf Coast Irrigation Company (hereinafter referred to as the "Corporation") made out, signed, executed and returned to the defendant's predecessor in office its returns of its income from all sources for the fiscal year and the fiscal period above set [fol. 4] forth, which returns were made out in accordance with forms prescribed by the Commissioner of Internal Revenue and were filed with the defendant's predecessor in office within the times prescribed by said Revenue Act.

V

After the dissolution of said Corporation and during the year 1934, the Commissioner of Internal Revenue assessed additional income taxes against plaintiff as Transferee of said Corporation on account of the income of the Corporation for said fiscal year and fiscal period, together with in-

terest thereon, all of which amounts of additional income taxes and interest thereon being as follows:

For the fiscal year beginning April 1, 1930, and ending March 31, 1931:

Principal	\$7,963.07
Interest	1,460.84
Total	<u>\$9,423.91</u>

For the fiscal period beginning April 1, 1931, and ending November 21, 1931:

Principal	\$36,422.83
Interest	4,496.47
Total	<u>\$40,919.30</u>

Plaintiff paid said additional income taxes and interest as above set forth to the defendant on or about July 16, 1934.

VI

Said additional tax for the fiscal year ended March 31, 1931, was due to the disallowance by the Commissioner of Internal Revenue of a loss for the fiscal year ended March [fol. 5] 31, 1930, carried forward into the fiscal year ended March 31, 1931, and the disallowance by the Commissioner of a certain amount of depreciation, the recomputation of said Corporation's income for said year by the Commissioner being as follows:

Net loss as shown on return	\$385,181.93
Additions to income by Commissioner:	

- (a) Net loss for fiscal year ended March 31, 1930, disallowed by Commissioner 449,584.79
- (b) Depreciation disallowed 1,956.13

451,540.92

Net income as corrected by Commissioner	66,358.99
Income tax	7,963.07
Tax previously assessed	None
Additional tax assessed by the Commissioner	<u>\$7,963.07</u>

The Corporation for the fiscal year ended March 31, 1930, had shown by its income tax return for that year a net loss

of \$449,584.79, which loss it brought forward under the Revenue Act of 1928 into its return for the fiscal year ended March 31, 1931, but the Commissioner in assessing the tax on account of the Corporation's income for the year ended March 31, 1931, disallowed this entire loss of \$449,584.79, and decided that instead of having said net loss said Corporation had a net income for the fiscal year ended March 31, 1930, of \$9,002.70. The Commissioner arrived at said decision by disallowing deductions upon the return of the Corporation for the fiscal year ended March 31, 1930, of \$458,587.49, so that the Commissioner recomputed the net income of the Corporation for the fiscal year ended March 31, 1930, as follows (the Corporation having filed a consolidated [fol. 6] return with its affiliates Markham Irrigation Company and Texas Irrigation Company):

Net loss as shown on return (\$449,584.79)

Additions by Commissioner due to disallowances of deductions taken on return:

- (a) Depreciation on canals and laterals Gulf Coast Irrigation Company 2,521.16
- (b) Depreciation on canals and lateral Markham Irrigation Company 13,248.50
- (c) Depreciation on canals and laterals Texas Irrigation Company 8,190.43
- (d) Bad debts Markham Irrigation Company:

Accounts Receivable:

- (2) A. J. Harty—
new account 44,378.38
- (3) A. J. Harty—
old account 1,876.29

[fol. 7]

- (4) Harty and Herder 6.74
- (5) Geo. Herder, Sr. 338.16
- (6) J. C. Lewis, Trustee 2,406.22
- (7) O. A. Ulland 250.00
- (8) E. W. Turner 733.33

Notes Receivable:

(9) A. J. Harty	11,517.26	
(10) E. W. Turner	57,313.73	
		<u>118,820.11</u>
(e) Bad debts Texas Irrigation Company		126,613.99
(f) Bad debts Matagorda Canal Company		40,140.00
(g) Losses sustained Gulf Coast Irrigation Company		124,856.22
(h) Losses sustained Markham Irrigation Company		24,197.08
		<u>458,587.49</u>

Net income for fiscal year ended March 31, 1930,
as determined by the Commissioner \$9,002.70

Of the above disallowances, plaintiff has not taken exception to the items occurring in (a), (b), (c), (e) and (f), but plaintiff alleges that the disallowances set forth in (d), (g) and (h) were improperly disallowed for the reason hereinafter stated, and therefore plaintiff alleges that the [fol. 8] Corporation for the fiscal year ended March 31, 1930, had a net loss of \$258,870.71, arrived at as follows:

Net loss as shown on return (\$449,584.79)

Add deductions disallowed to which plaintiff does not take exception:

(a) Depreciation on canals and laterals Gulf Coast Irrigation Company	2,521.16	
(d) Depreciation on canals and laterals Markham Irrigation Company	13,248.50	
(c) Depreciation on canals and laterals Texas Irrigation Company	8,190.43	
(e) Bad debts Texas Irrigation Company	126,613.99	
(f) Bad debts Matagorda Canal Company	40,140.00	
		<u>190,714.08</u>

Net loss for fiscal year ended March 31, 1930 (\$258,870.71)

The deductions of bad debts listed in item (d) above were improperly disallowed by the Commissioner. They were debts that were ascertained during the fiscal year ended March 31, 1930, to be worthless and were charged off by the Corporation during said fiscal year, and were therefore proper deductions for that fiscal year.

The deduction of \$124,856.22 referred to in item (g) above was a proper deduction. That item represented the cost to the Gulf Coast Irrigation Company of stock it owned in the Markham Irrigation Company. During the fiscal year ended March 31, 1930, this plaintiff, who held a mortgage lien upon the assets of Markham Irrigation Company, fore-[fol. 9] closed the mortgage and bought in all the properties of the Markham Irrigation Company. As the Markham Irrigation Company had no assets after that foreclosure, the stock became worthless during said fiscal year and the Corporation was entitled to deduct the cost of this stock as a loss occurring during said fiscal year.

The loss sustained by Markham Irrigation Company of \$24,197.08, referred to in item (h) above, plaintiff alleges was a proper deduction for said fiscal year. This item represented certain real estate that Markham Irrigation Company owned at the time of the above mentioned foreclosure by this plaintiff during this fiscal year, said amount being the cost of said real estate to the Markham Irrigation Company. After the foreclosure sale, the Markham Irrigation Company no longer owned this land. In the income tax return for this fiscal year the amount received by the Markham Irrigation Company at said foreclosure sale was reported and duly returned but in determining whether there was a profit or loss on account of such sale this amount of \$24,197.08 was not included in the cost of the properties sold at said foreclosure sale but on the other hand was simply returned as an item of real estate being written off. Plaintiff alleges that even if the proper way for the Corporation to have treated this item would have been to include it in the cost to Markham Irrigation Company of the properties sold at said foreclosure sale instead of writing it off as a loss, nevertheless, the result in either case is the same, and that whether the cost of the properties to Markham Irrigation Company so sold is increased by said amount or said amount is simply written off as a loss, the net result is that income of Markham Irrigation Company for said year properly includes a deduction of this item of \$24,197.08.

[fol. 10] Plaintiff alleges, therefore, that for the fiscal year ended March 31, 1930, the Corporation had a net loss of \$258,870.71.

As hereinabove stated, the Commissioner determined that for the fiscal year ended March 31, 1931, the Corporation had improperly deducted a net loss for the fiscal year ended March 31, 1930, of \$449,584.79 and depreciation in the amount of \$1,956.13. The plaintiff alleges that the Corporation had a loss for the fiscal year ended March 31, 1930, of at least \$258,870.11. Said Corporation deducted for the fiscal year ended March 31, 1931, a loss of \$449,584.79 for the fiscal year ended March 31, 1930. For the purposes of this suit plaintiff will agree that said loss should be only \$258,870.11 and that the difference between that amount and the loss that the Corporation actually deducted of \$449,584.79, or \$190,714.68 may be disallowed as a deduction and the Corporation's income increased by that amount. The plaintiff also agrees that said item of \$1,956.13 depreciation disallowed by the Commissioner may be disallowed and that the Corporation's income may be increased by that amount. Plaintiff alleges that the Corporation's income for said fiscal year should be computed as follows:

Net loss as shown on return	\$385,181.93
Additions to income:	
(a) Reduction in net loss for year ended March 31, 1930	190,714.68
(b) Depreciation disallowed	1,956.13
	<hr/>
	192,670.81
Net loss for fiscal year	<hr/>
	\$192,511.12

Plaintiff therefore alleges that for said fiscal year ended March 31, 1931; said Corporation instead of having a net income on account of which the Commissioner assessed said additional taxes against this plaintiff, the Corporation had a net loss, and plaintiff therefore alleges that the tax of [fol. 11] \$7,963.07 and interest thereon of \$1,460.84 was improperly and illegally collected from the plaintiff and that the plaintiff should have a judgment for said amounts against the defendant, together with interest at the rate of 6% per annum thereon from June 8, 1934.

VII

The additional tax for the fiscal period beginning April 1, 1931, and ended November 21, 1931, was due to the addition by the Commissioner of Internal Revenue of \$301,124.04, claimed by the Commissioner to be the profit of the Corporation on what the Commissioner claims was a sale of the Corporation's assets in November, 1931, so that the total income of the Corporation for said period upon which the Commissioner computed and assessed said tax was arrived at by him as follows:

Net income as shown on return	\$2,399.54
Profit realized on sale of assets	301,124.04
<hr/>	
Total net income	\$303,523.58
Income tax at 12%	36,422.83
Original assessment	None
<hr/>	
Deficiency assessed against and paid by plaintiff	\$36,422.83

Plaintiff alleges that the Corporation derived no taxable profit in the disposition of said assets and the inclusion of said claimed profit in its taxable income was illegal and not warranted by law. Plaintiff alleges that the facts in connection with said disposition of said assets were as follows:

On or about November 4, 1931, the Corporation, plaintiff (who owned all the stock of the Corporation) and Gulf Coast Water Company, a corporation, entered into a plan of reorganization, under and by virtue of which plan it was [fol. 12] provided that the Corporation would transfer substantially all of its properties to Gulf Coast Water Company for \$50,000.00 in cash and bonds of Gulf Coast Water Company in the aggregate principal amount of \$750,000.00, to be dated September 1, 1931, to bear interest at 6% per annum, and to mature as follows, (said bonds being 27 in number, Nos. 1 to 15 being for \$10,000.00 each and Nos. 16 to 27 being for \$50,000.00 each):

Number of Bond	Principal Amount of Bonds	Maturity Date
1 to 16	\$200,000	Jan. 1, 1933
17	50,000	Jan. 1, 1934
18	50,000	Jan. 1, 1935
19	50,000	Jan. 1, 1936
20	50,000	Jan. 1, 1937
21	50,000	Jan. 1, 1938
22	50,000	Jan. 1, 1939
23	50,000	Jan. 1, 1940
24	50,000	Jan. 1, 1941
25	50,000	Jan. 1, 1942
26	50,000	Jan. 1, 1943
27	50,000	Jan. 1, 1944

Said bonds were to be secured by a vendor's lien upon the properties retained in the deed conveying them to Gulf Coast Water Company and also by a deed of trust upon all said properties from Gulf Coast Water Company to J. C. Lewis, Trustee. Plaintiff joined in the plan of reorganization and agreed personally to warrant the title of the Corporation to the properties transferred. In pursuance of the plan of reorganization the Corporation on or about November 18, 1931, transferred said properties to Gulf Coast Water Company which in turn executed and delivered to the Corporation said bonds and deed of trust and paid said \$50,000.00 in cash. The Corporation in pursuance of [fol. 13] said plan of reorganization immediately distributed to plaintiff as its sole stockholder the said bonds and cash and on November 21, 1931, surrendered its charter to the State of Texas, dissolved and ceased to be a corporation.

Plaintiff alleges that under the Revenue Act of 1928 and particularly under — by virtue of Section 112 (i) (1) (A), Section 112 (b) (4) and Section 112 (d) (1) thereof, no part of the profit, if any, that accrued to the Corporation in said reorganization was subject to any income tax, and that under said sections no gain to the Corporation is to be recognized as taxable on account of said reorganization and the assessment of said additional income tax on account thereof and the collection thereof from plaintiff was wholly unauthorized.

In addition, as shown hereinabove in paragraph VI, the Corporation had a net loss of \$192,511.12 for the fiscal year ended March 31, 1931, which it was entitled to bring forward into the period ended November 21, 1931, and as a result instead of having a net income of \$2,399.54 for said period, it had a net loss of \$190,112.18, with no income tax liability for said period at all.

VIII

Pleading in the alternative, and only in the event it should be held that the profit of the Corporation, in said reorganization of November, 1931, was taxable, plaintiff alleges that it did not derive as large a taxable profit from the transfer of its assets as the Commissioner computed in assessing said additional tax against plaintiff. The Commissioner determined said profit as follows:

Gulf Coast Water Company had the option to retire at any time prior to September 1, 1932, \$50,000.00 of the bonds maturing January 1, 1933, and the \$550,000.00 of bonds [fol. 14] maturing thereafter, by which Gulf Coast Water Company had the option to September 1, 1932, to retire said \$600,000.00 of bonds for \$500,000.00. The Commissioner held that all said bonds had a fair market value when received by the Corporation equal to their face value less said \$100,000.00 discount under said option, and computed the profit realized as follows:

Consideration received by the Corporation:

Cash	\$50,000.00
\$150,000 bonds	150,000.00
\$600,000 bonds	500,000.00
Total	\$700,000.00
Deduct:	
Cost of assets	398,875.96
Profit realized	\$301,124.04

Plaintiff alleges that the fair market value of said bonds at the time of their receipt by the Corporation was not more than sixty per cent (60%) of their principal amount. Plaintiff further shows that the Corporation had agreed to pay a commission of \$60,000.00 on the transfer of said properties, of which \$40,000.00 was to be paid out of the

proceeds of said bonds and an interest in said bonds to the extent of \$40,000.00 was assigned and accrued to the parties to whom this commission was payable and from the fair market value of plaintiff's interest in the bonds must be deducted said \$40,000.00.

Plaintiff further shows that the cost of said properties or basis to the Corporation was \$434,506.31 instead of \$398,875.96 taken by the Commissioner.

Plaintiff further shows that for the fiscal year ended March 31, 1931, the Corporation had a loss of \$192,511.72, as hereinbefore set forth, which it was entitled to carry forward as a loss in the period ended November 21, 1931.

[fol. 15] Plaintiff, therefore, alleges that, if the Corporation received a taxable profit on account of said reorganization in November, 1931, its taxable profit is determined as follows:

Consideration received by the Corporation:

Cash	\$50,000.00
\$150,000 of bonds @ 60%	90,000.00
\$600,000 of bonds @ 60% or \$360,000, less \$40,000 interest therein assigned as com- mission	320,000.00

Total consideration received \$460,000.00

Deduct:

Cost of assets 434,506.31

Profit realized \$25,493.69

Therefore, plaintiff alleges the Corporation's income would under those circumstances be as follows:

Net income as per return \$2,399.54

Add:

Profit on assets 25,493.69

Total \$27,893.23

Deduct:

Loss for fiscal year ended March 31, 1931 192,511.72

Net loss for period \$164,618.49

There being no taxable income, plaintiff alleges he is entitled to a refund of said additional taxes assessed against and paid by him for said period.

IX

Pleading further in the alternative, and only in the event it should be held that the profit of the Corporation in said reorganization of November, 1931, was taxable and that the [fol. 16] fair market value of said bonds when received by the Corporation was equal to their full principal amount, plaintiff alleges that said profit and the taxable income of the Corporation for said period ended November 21, 1931, was as follows:

Consideration received:

Cash	\$50,000.00
\$150,000 bonds	150,000.00
\$600,000 of bonds less \$100,000 discount under abovementioned option, less \$40,- 000 interest therein assigned as commis- sion	460,000.00
Total	\$660,000.00
Deduct:	
Cost of assets	434,506.31
Profit	\$225,493.69
Net income per return	\$2,399.54
Profit on assets	225,493.69
Total income	\$227,893.23
Deduct loss for fiscal year ended March 31, 1931	192,511.72
Taxable income	\$35,381.51
Tax at 12%	\$4,245.78
Tax assessed against and paid by plaintiff	36,422.83
Overpayment by plaintiff	\$32,177.05

Plaintiff, therefore, alleges that he is entitled to the return to him of said \$32,177.05 with interest thereon from date of payment.

[fol. 17]

X

During the year 1934 and within less than two years after the date on which plaintiff paid said taxes and interest, plaintiff duly filed with defendant at Austin, Texas, his

claims for the refund to him of said taxes and interest, separate claims being filed for the fiscal year ended March 31, 1931, and the period ended November 21, 1931, all in accordance with the laws of the United States and the rules and regulations prescribed by the Commissioner of Internal Revenue and the Secretary of the Treasury. In said claims for refund, plaintiff claimed that said taxes and interest should be refunded to him on the same grounds and for the same reasons as are set forth in this petition as the grounds and reasons upon which he should recover said taxes and interest from the defendant. More than six months have expired since the said claims for refund were filed by the plaintiff, but the Commissioner of Internal Revenue has not as yet rendered a decision on them or either of them.

Wherefore, premises considered, plaintiff prays that the defendant be cited to appear and answer this petition, and that upon a hearing hereof, plaintiff have and recover judgment against the defendant for the amounts of all of said taxes and interest thereon paid by plaintiff as more fully hereinabove alleged, or in the various alternatives hereinabove set forth the various amounts to which plaintiff alleges in each alternative that he is entitled with the corresponding part of said interest paid by him, together with interest thereon at the rate of six per cent (6%) per annum from the time plaintiff paid defendant said taxes and interest, and for all his costs herein incurred, and [fol. 18] for such other and further relief, general and special, to which he may be entitled.

W. E. Devant, Homer L. Bruce, Baker, Botts, Andrews & Wharton. By Homer L. Bruce, Attorneys for Plaintiff.

[File endorsement omitted.]

IN UNITED STATES DISTRICT COURT

No. 1412 Law

[Title omitted]

ANSWER—Filed Dec. 9, 1936

I

Now comes the defendant by his attorney, W. R. Smith, Jr., United States Attorney for the Western District of

Texas, and demurs generally to plaintiff's original petition herein and says that same is insufficient in law to require this defendant to answer, and of this defendant prays judgment of the court that plaintiff take nothing and that defendant be discharged with its costs.

II

For answer herein, if such be required, without waiving the foregoing demurrer, defendant denies each and every, all and singular, the material allegations in plaintiff's petition contained, and of this puts itself upon the country.

Wherefore, defendant prays judgment of the court that it be discharged with its costs and for such other relief as to the court may seem just.

W. R. Smith, Jr., United States Attorney.

•[File endorsement omitted.]

IN UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT
OF TEXAS, AUSTIN DIVISION.

No. 1413 At Law

V. L. LeTULLE, Plaintiff,

VS.

FRANK SCOFIELD, United States Collector of Internal Revenue
for The First District of Texas, Defendant

PLAINTIFF'S FIRST AMENDED ORIGINAL PETITION—Filed June
23, 1937

To the Honorable Judge of Said Court:

Comes now V. L. LeTulle, a citizen of the State of Texas, hereinafter called plaintiff, and, with leave of the Court [fol. 20] first had and obtained, files this his first amended original petition, complaining of Frank Scofield as Collector of Internal Revenue for the United States for the First District of Texas, hereinafter called defendant, and shows to the Court as follows:

I

Plaintiff is, and has been at the various dates hereinafter alleged, a citizen of the State of Texas residing in Bay City, Matagorda County, Texas.

II

Defendant is, and was on the various dates hereinafter alleged, the duly appointed, qualified, and acting United States Collector of Internal Revenue for the First District of Texas, which district includes Matagorda County, Texas, and as such Collector he was invested with the power and authority to collect taxes upon the income of persons and corporations within said district that were levied and assessed under and by virtue of the Act of Congress designated as the Revenue Act of 1928. The residence of the defendant is at Austin, Travis County, Texas.

III

Plaintiff's cause of action is to recover from the defendant the amounts of income taxes for the year 1931 and interest thereon paid to the defendant by plaintiff individually and by plaintiff as survivor of community of himself and wife Mrs. V. L. LeTulle and as sole heir of his wife. Plaintiff and his wife were during 1931 residents and citizens of Bay City, Texas, and all of their property and income were community property and community income. For said year plaintiff and his wife duly filed separate income tax returns with the defendant. Thereafter plaintiff's wife died intestate during the year 1933, and plaintiff was and is her sole heir and became the survivor of the community of himself and his wife. During the year 1934 the Commissioner assessed additional income taxes against plaintiff and his said wife for the year 1931 in the amount of \$35,642.16 in each case, together with interest thereon in each case of \$4,692.07. Plaintiff on or about June 8, 1934, paid defendant the said \$35,642.16 additional tax and \$4,692.07 interest assessed on his own income, and on or about June 8, 1934, plaintiff as survivor of community of himself and his wife and as the sole heir of his wife paid defendant the said \$35,642.16 additional tax and \$4,692.07 interest assessed on his wife's income. The administration of the community estate of plaintiff and his wife has been completed and plaintiff individually is

now entitled to the recovery herein sought of said taxes and interest paid by him as said survivor of the community of himself and his wife and as the sole heir of his wife.

IV

Said additional tax was due to the following changes made by the Commissioner of Internal Revenue in computing the combined income of plaintiff and his wife:

Net income as shown by returns (being entirely ordinary income and including none as capital gains)		\$82,296.38
Deduct (as included in return):		
(1) Profit on liquidation of Gulf Coast Irrigation Com- pany (included at a higher amount below by the Com- missioner)	\$76,358.40	
[fol. 22] (2) Dividend reported as ordinary income (in- cluded in profit on liquida- tion below)	15,339.78	91,698.18
Deficit		9,401.80
Add following changes by Com- missioner:		
(3) Reduction in Loss on ranch	3,245.00	
(4) Reduction in interest paid	6,906.17	
(5) Bad debts disallowed	1,773.73	
(6) Profit on liquidation of Gulf Coast Irrigation Co. (ordinary income)	283,062.28	
(7) Profit on same liquidation (capital gain)	190,147.21	485,134.39
Net income		\$475,732.59

Plaintiff will not contest the disallowances in items (3), (4) and (5) above.

Plaintiff alleges that the Commissioner erred in including the above items (6) and (7) profit on liquidation of Gulf Coast Irrigation Company and plaintiff and his wife

likewise erred in including the above item of \$76,358.40 as profit on said liquidation as there was no taxable profit to plaintiff and his wife in connection with said liquidation. Plaintiff alleges that the facts in reference to said liquidation were as follows:

On or about November 4, 1931, the Gulf Coast Irrigation Company, plaintiff (who owned all the stock of the Gulf Coast Irrigation Company) and Gulf Coast Water Company, a corporation, entered into a plan of reorganization, [fol. 23] under and by virtue of which plan it was provided that the Gulf Coast Irrigation Company would transfer substantially all of its properties to Gulf Coast Water Company for \$50,000.00 in cash and bonds of Gulf Coast Water Company in the aggregate principal amount of \$750,000.00, to be dated September 1, 1931, to bear interest at 6% per annum, and to mature as follows, (said bonds being 27 in number, Nos. 1 to 15 being for \$10,000.00 each and Nos. 16 to 27 being for \$50,000.00 each):

Number of Bond	Principal Amount of Bonds	Maturity Date
1 to 16	\$200,000	Jan. 1, 1933
17	50,000	Jan. 1, 1934
18	50,000	Jan. 1, 1935
19	50,000	Jan. 1, 1936
20	50,000	Jan. 1, 1937
21	50,000	Jan. 1, 1938
22	50,000	Jan. 1, 1939
23	50,000	Jan. 1, 1940
24	50,000	Jan. 1, 1941
25	50,000	Jan. 1, 1942
26	50,000	Jan. 1, 1943
27	50,000	Jan. 1, 1944

Said bonds were to be secured by a vendor's lien upon the properties retained in the deed conveying them to Gulf Coast Water Company and also by a deed of trust upon all said properties from Gulf Coast Water Company to J. C. Lewis, Trustee. Plaintiff joined in the plan of reorganization and agreed personally to warrant the title of the Gulf Coast Irrigation Company to the properties transferred.

In pursuance of the plan of reorganization the Gulf Coast Irrigation Company on or about November 18, 1931, transferred said properties to Gulf Coast Water Company which in turn executed and delivered to the Gulf Coast Irrigation [fol. 24] Company said bonds and deed of trust and paid said \$50,000.00 in cash. The Gulf Coast Irrigation Company in pursuance of said plan of reorganization immediately distributed to plaintiff as its sole stockholder the said bonds and cash and on November 21, 1931, surrendered its charter to the State of Texas, dissolved and ceased to be a corporation. In connection with said distribution of the assets of Gulf Coast Irrigation Company, plaintiff received cash and property at its fair market value totaling \$94,152.17 and assumed liabilities of Gulf Coast Irrigation Company of \$120,096.87.

The transaction between Gulf Coast Irrigation Company, Gulf Coast Water Company and plaintiff was a reorganization within the terms of Section 112 (i) (1) (A) of the Revenue Act of 1928 and as to the bonds was a tax free reorganization for Gulf Coast Irrigation Company under Section 112 (b) (4). Gulf Coast Irrigation Company immediately dissolved and distributed the bonds and cash to plaintiff as its sole stockholder and Gulf Coast Irrigation Company was not subject to any tax under Section 112 (d) (1). The distribution of the bonds and cash to plaintiff was tax free under Section 112 (b) (3) as to the bonds. Plaintiff under Section 112 (c) (1) would be taxable on any profit only to the extent of the cash and other property received by him but plaintiff assumed liabilities of Gulf Coast Irrigation Company to an amount greater than the cash and fair market value of the property received by him and plaintiff therefore alleges neither he nor his wife received any taxable income because of said liquidation of Gulf Coast Irrigation Company.

Plaintiff alleges that said bonds of Gulf Coast Irrigation Company when received by him had a fair market value of not over sixty per cent (60%) of their principal amount. In addition, when he received said bonds, there was out-[fol. 25] standing in other parties an interest in them to the extent of \$40,000.00.

Plaintiff alleges that the amount received by him on the liquidation of Gulf Coast Irrigation Company is properly as follows:

(a) Bonds of Gulf Coast Water Co.:		
\$150,000 at 60%	\$90,000.00	
\$600,000 at 60% less \$40,000	320,000.00	
		<u>410,000.00</u>

(b) Cash and property:		
A. Reported as ordinary dividend	15,339.78	
B. Cash (net)	42,950.42	
C. Notes Receivable	33,421.96	
D. Real Estate	2,440.00	
		<u>94,152.16</u>

Less liabilities assumed:

E. Accounts payable	55,000.00		
F. Advalorem taxes in dispute	6,787.85		
G. Bryan Jackson account	13,547.86		
H. Revenue Stamps	375.26		
J. Income taxes of Gulf Coast Irrigation Co. for year ended March 31, 1931	7,963.07		
K. Income taxes of Gulf Coast Irrigation Co. for period ended Nov. 21, 1931	36,422.83	120,096.87	-25,944.71

Net amount received on liquidation			<u>384,055.29</u>
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[fol. 26]. (c) Cost of stock in Gulf Coast Irrigation Co.:

L. 510 shares	19,046.00	
M. 490 shares	40,350.00	
N. 150 shares	15,000.00	
O. 1510 shares	151,000.00	
		<u>225,396.00</u>

Net profit		<u>\$158,659.29</u>
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As plaintiff assumed liabilities of Gulf Coast Irrigation Company in excess of the cash and property received by him, under Section 112 (c) (1) he was not subject to any income tax on account of said net profit.

Plaintiff further shows that during 1931 Gulf Coast Water Company paid bonds Nos. 1 to 7 of \$70,000.00 and plaintiff's cost basis for said bonds was \$11,693.08, resulting in a profit to him of \$58,306.92; and in 1931 said company paid \$6,648.30 on bond No. 8 and plaintiff's cost basis therefor was \$1,110.56, resulting in a profit to plaintiff of \$5,537.74.

Plaintiff therefore alleges that the net taxable income of himself and wife and their income tax liability was for 1931 as follows:

Net income per return		\$82,296.38
Deduct (as included in return):		
(1) Profit on liquidation of Gulf Coast Irrigation Co.	\$76,358.40	
(2) Dividend, reported as ordinary income (part of liquidating distribution)	15,339.78	
		<u>91,698.18</u>
Deficit		-9,401.80
[fol. 27] Add:		
(3) Reduction in loss on ranch	3,245.00	
(4) Reduction in interest paid	6,906.17	
(5) Bad debts disallowed	1,773.73	
(6) Profit on liquidation of Gulf Coast Irrigation Co.	0.00	
(7) Profit on bonds Nos. 1 to 7	58,306.92	
(8) Profit on payment of \$6,648.30 received on bond No. 8	5,537.74	
		<u>75,769.56</u>
Taxable income on community basis		\$66,367.76
One-half to each spouse		\$33,183.88
Less:		
Dividends	2,672.50	
Personal exemption and credit for dependents	2,150.00	
		<u>4,822.50</u>
Balance subject to normal tax		\$28,361.38

Normal tax at 1½% on \$4,000	60.00	
Normal tax at 3% on \$4,000	120.00	
Normal tax at 5% on \$20,- 361.38	1,018.07	
Surtax on \$33,183.88	1,146.54	
		<u>2,344.61</u>

Less:

Earned income credit	28.25
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Income tax liability	\$2,316.36
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Income tax assessed and paid:

As shown by original return	3,110.84	
Paid in June, 1934	35,642.16	38,753.00

Overpayment by plaintiff for himself and wife in each case	\$36,436.64
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[fol. 28] Plaintiff therefore alleges that he is entitled to a judgment against defendant for the two amounts of \$35,642.16 income taxes and the two amounts of interest of \$4,692.07 which he paid as above alleged.

Pleading in the alternative, in the event that it should be held that plaintiff was subject to the income tax to the extent of the full \$94,152.16 in cash and property received on the liquidation of Gulf Coast Irrigation Company without deduction of the liabilities assumed, then plaintiff alleges:

Plaintiff had acquired the stock in Gulf Coast Irrigation Company in four separate lots: 510 shares acquired in January, 1927; 490 shares in May, 1928; 150 shares in November, 1931, in exchange for land bought by plaintiff in 1922, which was a tax free transaction under the Revenue Act of 1928; and 1510 shares in November, 1931. Under Section 101 (c) (8) of the Revenue Act of 1928 the period plaintiff owned said land is to be included and therefore in November, 1931, the 150 shares were capital assets under said Revenue Act.

The original cost of said stock was \$225,396.00, as set forth more in detail hereinafter, and as plaintiff became liable for \$120,096.87 of the liabilities of Gulf Coast Irrigation Company upon its dissolution, said \$120,096.87 is to

be added to the cost of said stock so that the total cost thereof was as follows:

	Original Cost	Liabilities Assumed	Total Cost
510 shares	19,046.00	23,026.10	42,072.10
490 shares	40,350.00	22,123.10	62,473.10
150 shares	15,000.00	6,772.39	21,772.39
1510 shares	151,000.00	68,175.28	219,175.28
2660 shares	225,396.00	120,096.87	345,492.87

[fol. 29] Plaintiff alleges that said taxable income of \$94,152.16 is to be allocated as between the 1,150 shares held for more than two years and the other 1,510 shares in the amounts of \$40,704.88 and \$53,447.28, respectively.

Plaintiff further alleges that during the year 1931 bonds Nos. 1 to 7 of \$70,000 and \$6,648.30 of bond No. 8 were paid; that of said \$750,000.00 of bonds, \$143,797.00 are to be allocated to said 510 shares, the stock earliest acquired by him; that said 510 shares cost plaintiff \$42,072.10; that said total cost allocated to each \$1,000 bond gave plaintiff a basis for each \$1,000 bond of \$291.844; that his total basis for said \$76,648.30 of bonds was \$22,369.35, and his total taxable profit thereon was \$54,278.95.

Plaintiff therefore alleges that the net taxable income of himself and wife and their income tax liability for 1931 was as follows:

Net income per return		\$82,296.38
Deduct (as included in return):		
(1) Profit on liquidation of Gulf Coast Irrigation Company:	\$76,358.40	
(2) Dividend reported as ordinary income (part of liquidating distribution)	15,339.78	91,698.18
Deficit		—9,401.80
Add:		
(3) Reduction in loss on ranch	3,245.00	
(4) Reduction in interest paid	6,906.17	
(5) Bad debts disallowed	1,773.73	
(6) Profit on liquidation of Gulf Coast Irrigation Company:		
Capital gain	40,704.88	
Ordinary income	53,447.28	

[fol. 30]

(7) Capital gain on bonds 1 to 8 54,278.95 160,356.01

Taxable income on community basis	150,954.21
One-half to each spouse	75,477.11
Less capital gain: one-half of 40,704.88 and \$54,278.95	47,491.92

Balance taxable at ordinary rates	27,985.19
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Less:

Dividends	2,672.50	
Personal exemption and credits for dependents	2,150.00	4,822.50

Balance subject to normal tax	23,162.69
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Normal tax at $1\frac{1}{2}\%$ on \$4,000.00	60.00
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Normal tax at 3% on \$4,000.00	120.00
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Normal tax at 5% on \$15,162.70	758.14
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Surtax on \$27,985.19	718.96
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Tax at $12\frac{1}{2}\%$ on capital gain of \$47,491.92	5,936.49
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Total tax	7,593.59
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•Less:

Earned income credit	28.25
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Income tax liability	7,565.34
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Income tax assessed and paid:

As shown by original return	3,110.84	
Paid in June, 1934	35,642.16	38,753.00

Overpayment by plaintiff for himself and wife in each case	\$31,187.66
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[fol. 31] Plaintiff therefore alleges that he is entitled to a judgment against defendant for the two amounts of \$31,187.66 income taxes and the two amounts of \$4,105.66 which he paid as above alleged.

V

Pleading in the alternative, and only in the event that it should be held that the said reorganization in November, 1931, and distribution of the assets of Gulf Coast Irrigation Company to plaintiff was not a tax free transaction, plaintiff alleges:

* The fair market value of the bonds when received by plaintiff was not over sixty per cent (60%) of the principal amount. When said bonds were received, they were subject to an assignment to other parties of an interest in them to the extent of \$40,000.00.

Plaintiff had acquired the stock in Gulf Coast Irrigation Company in four separate lots: 510 shares acquired in January, 1927; 490 shares in May, 1928; 150 shares in November, 1931, in exchange for land bought by plaintiff in 1922, which was a tax free transaction under the Revenue Act of 1928; and 1510 shares in November, 1931. Under Section 101 (c) (8) of the Revenue Act of 1928 the period plaintiff owned the said land is to be included and therefore in November, 1931, the 150 shares were capital assets under said Revenue Act.

In the computations set forth in paragraph IV hereof, it is shown that the amount received on the liquidation of Gulf Coast Irrigation Company was \$384,055.29, which is allocable among these lots of stock as follows:

510 shares	\$73,634.66
490 shares	70,747.03
150 shares	21,657.25
1510 shares	218,016.35
	<hr/>
	\$384,055.29

[fol. 32] The cost or basis to plaintiff of said stock to plaintiff and the profit realized by plaintiff thereon is as follows:

Stock	Received	Cost or Basis	Profit
510 shares	\$73,634.66	\$19,046.00	\$54,588.66
490 shares	70,747.03	40,350.00	30,397.03
150 shares	21,657.25	15,000.00	6,657.25
1510 shares	218,016.35	151,000.00	67,016.35
	<hr/>	<hr/>	<hr/>
	\$384,055.29	\$225,396.00	\$158,659.29

Capital gain represented by the 510, 490 and 150 shares	\$91,642.94
Ordinary income (1510 shares)	67,016.35
Total	\$158,659.29

In addition, in 1931, as above alleged bonds Nos. 1 to 7, and \$6,648.30 of bond No. 8 were paid. Plaintiff's basis on each bond would be 60% of its principal amount, and his profit would be 40%, so that his profit on bonds 1 to 7 (of \$70,000.00) was \$28,000.00 and on the payment on bond No. 8, \$2,659.32.

On said taxable basis, plaintiff therefore alleges the net taxable income of himself and wife and their income tax liability for 1931 was as follows:

Net income per return	\$82,296.88	
Deduct (as included in return):		
(1) Profit on liquidation of Gulf Coast Irrigation Co.	\$76,358.40	
(2) Dividend reported as ordinary income (part of liquidating distribution)	15,339.78	91,698.18
Deficit	—	\$9,401.80

[fol. 33] Add:

(3) Reduction in loss on ranch	3,245.00	
(4) Reduction in interest paid	6,906.17	
(5) Bad debts disallowed	1,773.73	
(6) Profit on bonds Nos. 1 to 7	28,000.00	
(7) Profit on bond No. 8	2,659.32	
(8) Profit on liquidation (ordinary income)	67,016.35	
(9) Profit on liquidation (capital gain)	91,642.94	201,243.51

Total community net income	\$191,841.71
One-half to each spouse	\$95,920.86

Less:

Capital gain ($\frac{1}{2}$ of \$91,642.94	\$45,821.47
Balance taxable at ordinary rates	\$50,099.39

Less:

Dividends	\$2,672.50	
Personal exemption and credit for dependents	2,150.00	4,822.50

Balance subject to normal tax	\$45,276.89	
Normal tax at 1½% on \$4,000	\$ 60.00	
Normal tax at 3% on \$4,000	120.00	
Normal tax at 5% on \$37,276.89	1,863.84	
Surtax on \$50,099.39	2,992.92	
Tax at 12½% on \$45,821.47	5,727.68	

Total tax	\$10,764.44	
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Less:

Earned income credit	28.25	
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Income tax liability	\$10,736.19	
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Income tax assessed and paid:

As shown by original return	\$3,110.84	
Paid in June, 1934	35,642.16	38,753.00

Overpayment by plaintiff for himself and wife in each case	\$28,016.81	
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[fol. 34] Plaintiff therefore alleges that he is entitled to a judgment against defendant for the two amounts of \$28,016.81 income taxes and the proportionate part of the two amounts of interest thereon which he paid as above alleged.

VI

Pleading in the alternative, and only in the event that it should be held that said reorganization in November, 1931, and distribution of the assets of Gulf Coast Irrigation Company to plaintiff was not a tax free transaction and that the fair market value of said bonds was 100% of their principal amount, plaintiff alleges:

When plaintiff received said bonds they were subject to an assignment to other parties of an interest in them of \$40,000.00 and subject to an option held by Gulf Coast Water Company to retire \$600,000.00 of the bonds for \$500,000.00 up to September 1, 1932.

Plaintiff here repeats the allegations in the third paragraph of Paragraph V hereof.

Plaintiff alleges that on said basis that the amount received by him on the liquidation of Gulf Coast Irrigation Company was as follows:

Bonds:

\$150,000 @ 100%	\$150,000.00	
\$600,000 less \$100,000 due to option and less \$40,000 assigned to others	460,000.00	
Cash and property (detailed in paragraph IV hereof)	94,152.16	704,152.16
Less liabilities assumed (detailed in paragraph IV hereof)		120,096.87
Net amount received		<u>\$584,055.29</u>

[fol. 35] Said amount is allocable to the shares of stock in Gulf Coast Irrigation Company held by plaintiff, and the cost or basis of said stock to plaintiff, and the profit realized by plaintiff thereon is as follows:

Stock	Received	Cost or Basis	Profit
510 shares	\$111,980.53	\$19,046.00	\$92,934.53
490 shares	107,589.13	40,350.00	67,239.13
150 shares	32,935.45	15,000.00	17,935.45
1510 shares	331,550.18	151,000.00	180,550.18
	<u>\$584,055.29</u>	<u>\$225,396.00</u>	<u>\$358,659.29</u>

Capital gain represented by the 510, 490 and 150 shares	\$178,109.11
Ordinary income (1510 shares)	180,550.18
Total	<u>\$358,659.29</u>

On said taxable basis, plaintiff therefore alleges the net taxable income of himself and wife and their income tax liability for 1931 was as follows:

Net income per return		\$82,296.88
Deduct (as included in return)		
(1) Profit on liquidation of Gulf Coast Irrigation Co.	\$76,358.40	
(2) Dividend reported as ordinary income (part of liquidating distribution)	15,339.78	
		<u>91,698.18</u>
Deficit		<u>-\$9,401.80</u>
Add:		
(3) Reduction in loss on ranch	\$3,245.00	
(4) Reduction in interest paid	6,906.17	
(5) Bad debts disallowed	1,773.73	
(6) Profit on liquidation (ordinary income)	180,550.18	
(7) Profit on liquidation (capital gain)	178,109.11	
		<u>370,584.19</u>
Total community net income		\$361,182.39
One half to each spouse		\$180,591.20
[fol. 36] Less:		
Capital gain ($\frac{1}{2}$ of \$178,109.11)		89,054.55
Balance taxable at ordinary rates		<u>\$91,536.65</u>
Less:		
Dividends	\$2,672.50	
Personal exemption and credit for dependents	2,150.00	
		<u>4,822.50</u>
Balance subject to normal tax		\$86,714.15
Normal tax at $1\frac{1}{2}\%$ on \$4,000		\$60.00
Normal tax at 3% on \$4,000		120.00
Normal tax at 5% on \$78,714.15		3,935.71
Surtax on \$91,536.65		10,051.96
Tax on $12\frac{1}{2}\%$ on \$89,054.55		<u>11,131.82</u>
Total tax		<u>\$25,299.49</u>

Less:

Earned income credit	28.25
Income tax liability	<u>\$25,271.24</u>
Income tax assessed and paid:	
As shown by original return	\$3,110.84
Paid in June, 1934	<u>35,642.16</u>
	38,753.00
Overpayment by plaintiff for himself and wife in each case	<u>\$13,481.76</u>

Plaintiff therefore alleges that he is entitled to a judgment against defendant for the two amounts of \$13,481.76 income taxes and the proportionate amounts of interest thereon which he paid as above alleged.

[¶ 37]

VII

During the year 1934 and within less than two years after the date on which plaintiff paid said taxes and interest, plaintiff duly filed with defendant at Austin, Texas, his claims for the refund to him of said taxes and interest, separate claims being filed for the taxes and interest paid by him individually and by him as survivor of the community of himself and wife and as sole heir of his wife, all in accordance with the laws of the United States and the rules and regulations prescribed by the Commissioner of Internal Revenue and the Secretary of the Treasury. In said claims for refund, plaintiff claimed that said taxes and interest should be refunded to him on the same grounds and for the same reasons as are set forth in this petition as the grounds and reasons upon which he should recover said taxes and interest from the defendant. More than six months have expired since said claims for refund were filed by the plaintiff, and the Commissioner of Internal Revenue has rendered a decision on said claims rejecting the same and mailed by registered mail to the plaintiff a notice of the disallowance of said claims, said rejection and mailing of said notice having occurred within less than two years prior to the filing of this petition.

Wherefore, premises considered, plaintiff prays that the defendant be cited to appear and answer this petition, and that upon a hearing hereof, plaintiff have and recover

judgment against the defendant for the amounts of said taxes and interest thereon paid by plaintiff or in the various alternatives hereinabove set forth the various amounts to which plaintiff alleges in each alternative that he is entitled [fol. 38] titled with the corresponding part of said interest paid by him, together with interest thereon at the rate of six per cent (6%) per annum from the time plaintiff paid defendant said taxes and interest, and for all his costs, herein incurred, and for such other and further relief, general and special, to which he may be entitled.

Homer L. Bruce, W. E. Devant, Baker, Botts, Andrews & Wharton, by Homer L. Bruce, Attorneys for Plaintiff.

[File endorsement omitted.]

[fol. 39] IN UNITED STATES DISTRICT COURT

No. 1413 Law

[Title omitted]

ANSWER—Filed December 9, 1936

I

Now comes the defendant by his attorney, W. R. Smith, Jr., United States Attorney for the Western District of Texas, and demurs generally to plaintiff's petition herein and says that same is insufficient in law to require this defendant to answer, and of this defendant prays judgment of the court that plaintiff take nothing and that defendant be discharged with its costs.

II

For answer herein, if such be required, without waiving the foregoing demurrer, defendant denies each and every, all and singular, the material allegations in plaintiff's petition contained, and of this puts itself upon the country.

Wherefore, defendant prays judgment of the court that it be discharged with its costs and for such other relief as to the court may seem just.

W. R. Smith, Jr., United States Attorney.

[File endorsement omitted.]

[fol. 40] IN UNITED STATES DISTRICT COURT

No. 1412 At Law

No. 1413 At Law

[Titles omitted]

ORDER OF CONSOLIDATION—Filed June 24, 1937

On this 24th day of June, 1937, the motion of V. L. LeTulle, plaintiff in the above entitled causes, for the consolidation of the above entitled causes came on to be heard; and on inspection of the record, and the defendant in said causes appearing by his attorneys and consenting, it is thereupon ordered that said two causes be and they hereby are consolidated into one cause and thereafter shall proceed as one cause under the title of V. L. LeTulle vs. Frank Scofield, United States Collector of Internal Revenue for the First District of Texas, Consolidated Cause No. 1412 at Law, and that the orders and proceedings heretofore had in said causes, respectively, are hereby made orders and proceedings in this cause.

Robert J. McMillan, Judge.

Entered: Minute Volume L, page 351.

[fol. 41] IN UNITED STATES DISTRICT COURT

DEFENDANT'S MOTION FOR CONTINUANCE—Filed July 5, 1937

To the Honorable Robert J. McMillan, Judge of Said Court:

I

Comes now the defendant in the above-entitled proceedings by W. R. Smith, Jr., United States Attorney, H. W. Moursund, Assistant United States Attorney, and L. L. Gibson, Special Assistant to the Attorney General, and moves that the hearing in the above-entitled cases at San Antonio, Texas on July 5, 1937, be continued for a period of at least sixty days to some date convenient to the Court, and as reasons therefor shows to the Court as follows:

These cases were heard in part at Austin, Texas on June 24, 1937, at which time the plaintiff introduced his evidence

and the Court being unable to complete hearing on that date and not desiring to continue the hearing to the following day because criminal cases had been set for trial and a jury had been subpoenaed for that date, continued the hearing to July 5, 1937 at San Antonio, Texas.

II

At the hearing on June 24, 1937 the defendant's counsel requested the Court to allow the defendant time to secure the attendance of witnesses and produce documentary evidence which was not available at that time at Austin for the following reasons:— That attorneys for the defendant had requested the attorney for the plaintiff on June 1937, to have at the hearing the books and records of V. L. LeTulle and the Gulf Coast Irrigation Company, and in the event that he would not produce such records upon request, to notify attorneys for the defendant in time for them [fol. 42] to secure such books and records by subpoena. That the attorney for the plaintiff did not advise attorneys for the defendant that such books and records would not be made available at that hearing, nor were such books and records produced, with the exception of one page from the records of V. L. LeTulle or the Gulf Coast Irrigation Company which plaintiff placed in evidence. The plaintiff offered in evidence a part of the minutes of the meetings of the Directors of the Gulf Coast Irrigation Company relating to the transfer of its assets to the Gulf Coast Water Company in November, 1931, but did not have present the minute books of the Gulf Coast Irrigation Company or any evidence that such minute books could not be produced. Over objections of the defendant's counsel, the Court admitted in evidence the minutes offered by plaintiff's attorney but directed plaintiff's counsel to make available to defendant's counsel the minute books of the Gulf Coast Irrigation Company for the years 1930 and 1931, which has not been done.

III

On June 1937, upon the application of counsel for the defendant, this Court signed an order authorizing and directing the issuance of subpoenas duces tecum for the appearance at the hearing at San Antonio, Texas on July 5, 1937 of the following witnesses: E. J. Crofoot, Jules Ducross, E. L. McDonald, V. L. LeTulle, all of Bay City, Texas,

and to produce at the hearing various documentary evidence including the records of the Gulf Coast Irrigation Company, Gulf Coast Water Company, Central Public Service Company [fol. 43], and V. L. LeTulle, individually for the years 1930 and 1931; and also signed an order authorizing the issuance of subpoena duces tecum to E. C. Holt of Madison, Wisconsin, Secretary and Treasurer of the Continental Public Service Company and its subsidiaries, and for his appearance at said hearing and to produce the books and records of those concerns; and also a subpoena duces tecum for B. E. Buckman, Madison, Wisconsin, President of B. E. Buckman and Company to appear at San Antonio on July 5, 1937 and to produce the records of the B. E. Buckman and Company relative to certain transactions with V. L. LeTulle and the Gulf Coast Irrigation Company and the Gulf Coast Water Company, all of which are part of the Court files in these cases.

On June 29, 1937, upon the petition of the defendant's attorneys, this Court signed an order authorizing and directing the issuance of a subpoena duces tecum to R. G. Wertz, Bay City, Texas, Secretary, to produce at said hearing ledgers, journals, cash books, minute books, stock books, and other records of the Central West Water and Power Company, Gulf Coast Water Company, and Continental Public Service Company for the years 1930 and 1931, and also the original contract and any supplements thereto between V. L. LeTulle and the Gulf Coast Irrigation Company to sell certain assets to B. E. Buckman and Company; and also signed an order authorizing and directing the issuance of subpoena duces tecum to require the appearance of J. C. Lewis, Trustee, Bay City, Texas, to produce at said hearing the records of the trusteeship with respect to the bonds issued by the Gulf Coast Water Company to the Gulf Coast Irrigation Company in the acquisition of the assets involved in this proceeding, showing the receipts and disbursements of the Trustee for the years 1931 to 1934, inclusive.

That in accordance with the Court's authorization, subpoenas duces tecum were issued by the Clerk of this Court [fol. 44] and sent to the United States Marshal's office at Houston, Texas or Galveston, Texas for service on the witnesses residing at Bay City, Texas, and to the United States Marshal's office at Madison, Wisconsin, for service on the witnesses residing there.

That on June 30, 1937, the Court decided that the issuance of these subpoenas was not authorized by law and directed counsel for the defendant to advise the various persons subpoenaed to disregard any subpoenas served or any that might be served on them requiring their attendance at San Antonio, Texas on July 5, 1937, and that in accordance with the Court's directions, attorneys for the defendant sent telegrams to all of the witnesses subpoenaed in accordance with a copy of a telegram to Jules Ducross, Bay City, Texas, attached hereto.

On June 24, 1937, counsel for the defendant sent a telegram to J. Samuel Hartt, Madison, Wisconsin, who in 1931 appraised all the properties transferred to Gulf Coast Water Company, inquiring as to whether he was available to appear at San Antonio on July 5, 1937 and produce his appraisal of said properties, and on June 26, 1937 defendant's counsel received a telegram from Mr. Hartt stating that it would be impossible for him to be at San Antonio on July 5, 1937 and that all of his time was engaged until the latter part of July.

IV

Counsel for the defendant respectfully show to the Court that it is necessary to take depositions of these witnesses since the attendance of these witnesses cannot be secured upon a subpoena before the Court, in order to have before the Court the testimony of these witnesses and various and sundry documentary evidence, which testimony and documentary evidence are material and necessary in support of [fol. 45.] the defendant's defense of this case for the following reasons:

In these cases the plaintiff is seeking to recover from the defendant refunds of income taxes in the amount of approximately \$130,000.00, together with interest thereon. One of the principal issues in these cases is whether or not the Gulf Coast Water Company acquired the assets of the Gulf Coast Irrigation Company in November, 1931 in such a manner as to render the transaction a nontaxable one to the Gulf Coast Irrigation Company, and also whether the distribution of the consideration received by the Gulf Coast Irrigation Company for its assets to its sole stockholder, V. L. LeTulle, in dissolution was also a nontaxable transaction. In the evidence submitted to the Bureau of Internal Revenue and in the evidence submitted to the Court

at this hearing on June 24, 1937 by the plaintiff, it is represented that this was a sale or transaction which occurred solely in November, 1931; whereas, on June 23, 1937 for the first time counsel for the defendant came into possession of facts which tend to show that V. L. LeTulle and the Gulf Coast Irrigation Company sold the assets transferred in November, 1931 to the Gulf Coast Water Company prior thereto, to B. E. Buckman and Company, which company later transferred such contract to the Continental Public Service Company, the owner of all of the stock of the Gulf Coast Water Company after its organization in November, 1931, and that later the Continental Public Service Company transferred its contract of purchase to the Central West Water and Power Company, all the stock of which was owned by the former, which latter corporation transferred the contract to the Gulf Coast Water Company after its organization. The reports of Revenue Agent Campbell, who made the original investigation of these cases, state that in January, 1931 an option to sell said assets which [fol. 46] was exercised in November, 1931. The minutes, contract mortgage and other data put in evidence by the plaintiff make no reference to a prior contract of sale or even an option having been given to sell these assets.

V

From the information for the first time coming to the attention of counsel for the defendant on June 23, 1937, and that obtained since that date, counsel for the defendant believe that they will be able if all the evidence can be secured, to show to the Court that long prior to November, 1931, and prior to the time when V. L. LeTulle had transferred a substantial portion of assets to the Gulf Coast Irrigation Company for 1660 shares of its stock, that V. L. LeTulle and the Gulf Coast Irrigation Company had entered into a binding and valid contract to sell to the assignors of the Gulf Coast Water Company all the assets which were transferred to the Gulf Coast Water Company by the Gulf Coast Irrigation Company in the so-called reorganization of November, 1931, for the same consideration previously agreed upon.

VI

That defendant expects to prove by the witnesses and the documentary evidence listed below the following material and necessary facts to the defense of these suits:

That in November, 1930 or in January, 1931 V. L. LeTulle and the Gulf Coast Irrigation Company entered into a valid and binding contract to convey and transfer to B. E. Buckman and Company, Madison, Wisconsin, for \$800,000.00, all the assets which were in November, 1931 transferred by the Gulf Coast Irrigation Company to the Gulf Coast Water Company, and that said contract was sold and transferred by B. E. Buckman and Company to the Continental [fol. 47] Public Service Company of Bay City, Texas for 10,000 shares of its common stock and \$371,500.00 par value of its bonds, which latter company assumed the obligation to purchase said assets from V. L. LeTulle and the Gulf Coast Irrigation Company. That subsequently the Continental Public Service Company for a consideration of at least \$500,000.00, transferred and assigned said contract to Central West Water and Power Company, Bay City, Texas, a corporation, all of its stock then and at all-times material to this proceeding being owned by the Continental Public Service Company, and that thereafter in February or later in 1931, but prior to November 19, 1931, the Central West Water and Power Company sold and transferred said contract to the Gulf Coast Water Company, the consideration being the assumption by the latter company of the payment of said \$500,000.00 consideration owing by the Central West Water and Power Company to the Continental Public Service Company. That during all times material to this suit, the Continental Public Service Company, a corporation, owned all of the capital stock of the following corporations:

Eureka Utilities Company—Wisconsin corporation.

Interstate Public Service Company—Texas corporation.

Interstate Telephone Company—Texas corporation.

Central West Water & Power Company—Delaware corporation.

Gulf Coast Water Company—Texas corporation.

Hondo Deep Well Company—Texas corporation.

The Continental Public Service Company organized under the laws of Arkansas December 16, 1930, acquired all the assets and liabilities of the Midstate Public Service Company, a Delaware corporation organized May 17, 1928, and its subsidiaries were engaged in furnishing telephone, [fol. 48] water, gas and irrigation services to communities in Texas, Arkansas, and Wisconsin.

The Continental Public Service Company and its subsidiaries filed a consolidated return for 1931, which return showed that on January 1, 1931 they owned assets of the value of \$1,849,188.60, and on December 31, 1931 owned assets valued at \$3,637,247.60. In the 1931 consolidated return, the contract to purchase the properties of Gulf Coast Irrigation Company and V. L. LeTulle was listed as an asset valued at \$500,062.50, on January 1, 1931.

That on January 27, 1931, B. E. Buckman and Company, or the Continental Public Service Company, or Central West Water and Power Company paid to V. L. LeTulle and the Gulf Coast Irrigation Company \$10,000.00 and on February 10, 1931 paid to them \$15,000.00 in cash as part payment of the consideration for the purchase and acquisition of said properties and assets.

That at all times after the transfer of said contract from the Central West Water and Power Company to the Gulf Coast Water Company, which was prior to the contract and deed of November 19, 1931, the Gulf Coast Water Company held and owned the equitable title to the properties and assets purported to have been transferred to it by the said deed of November 19, 1931. That V. L. LeTulle and the Gulf Coast Irrigation Company at no time material to this proceedings owned any stock or interest in the Gulf Coast Water Company, the Central West Water and Power Company, and the Continental Public Service Company, or any of its other subsidiaries. That prior to November 7, 1931, when V. L. LeTulle transferred certain assets to the Gulf Coast Irrigation Company for 1660 shares of its stock, it is expected to prove and show that V. L. LeTulle had sold and contracted to sell said assets and that he should in his 1931 individual income tax return account for the profit [fol. 49] on said assets realized from the transfer later made by the Gulf Coast Irrigation Company.

That defendant and his counsel and representatives have not been since June 23, 1937, when the existence of said sale contract first came to their attention, permitted to examine the minute books of the Gulf Coast Irrigation Company and the Gulf Coast Water Company, Continental Public Service Company and Central West Water and Power Company, or been permitted to examine the said contract, but have examined unsigned typewritten supplements to said contract dated January 22, 1931 and July 30, 1931, and are therefore unable to more definitely advise the Court

as to the terms of said contract, but the statements herein that such a contract was executed and carried out are based upon information believed to be reliable and upon certain entries in the books of the Gulf Coast Irrigation Company and the Gulf Coast Water Company and other records.

The contract of sale between the Gulf Coast Irrigation Company and the Gulf Coast Water Company introduced in evidence by the plaintiff provides that the sale was effective as of January 1, 1931, and further provides that the income derived from the properties received by the Gulf Coast Water Company during the year 1931 after certain items had been taken care of, should be applied to the retirement of bonds Numbers 1 to 15, inclusive, of the par value of \$150,000.00. Defendant proposes to show that the net earnings of the Gulf Coast Water Company for the year 1931 which owned only the properties acquired from V. L. LeTulle and Gulf Coast Irrigation Company, amounted to at least \$160,000.00. It is expected to prove that in 1931 Jay Samuel Hartt appraised said properties at \$1,300,000.00, and also that all the bonds of the Gulf Coast Water Company were paid off by the end of 1935, which facts are material as to the question of the fair [fol. 50] market value of the bonds received from the Gulf Coast Water Company.

VII

The documentary evidence set out in the subpoenas heretofore issued on the application of the defendant is material and necessary evidence and it is believed that same will show as follows:

The minute book of the directors' meeting of the Gulf Coast Irrigation Company during 1930 and 1931 will reflect that the Directors of the Gulf Coast Irrigation Company authorized the entering into of the said contract and ratified all of the above transactions whereby the sale contract was transferred from B. E. Buckman and Company to the Continental Public Service Company, and then to the Central West Water and Power Company and then to the Gulf Coast Water Company, and that its other books and records also will reflect said sale.

The other books and records of the Gulf Coast Irrigation Company will show the amount and nature of the assets transferred to it by V. L. LeTulle on November 16, 1931

for 1660 shares of stock, and that the notes receivable aggregating \$33,421.96 transferred to that corporation in part payment for said stock were acquired by V. L. LeTulle from the Gulf Coast Irrigation Company on October 26 and 31, 1931 by journal entries on those dates, credited to his account and charged to notes receivable, and the transactions relating to the acquisition and cost of the stock of the Markham Irrigation Company should also be reflected by said books. These records should contain said contract of November, 1930 and the supplements thereto, or signed copies thereof. The books and records of the Markham Irrigation Company reflect the transactions as to the cost of its assets, which assets were turned in to the Gulf Coast [fol:51] Irrigation Company for said 1660 shares of stock, the cost of which is in controversy. At the hearing on June 24, 1937, plaintiff did not produce any of the books and records of the Markham Irrigation Company, and only one page from the books of the Gulf Coast Irrigation Company, being the account of V. L. LeTulle beginning March 31, 1930 called "V. L. LeTulle-Markham Property Account"; nor did plaintiff produce the minute book of the Gulf Coast Irrigation Company.

That the records of the B. E. Buckman and Company will reflect and show the entering into of said contract with V. L. LeTulle and the Gulf Coast Irrigation Company, and the subsequent transfer of this contract to the Central Public Service Company, and the consideration received therefor, and will also include the original or a duplicate copy of said contract and the supplements thereto dated January 22, 1931 and July 30, 1931. The plaintiff and his attorneys and the officers of the Gulf Coast Water Company, Continental Public Service Company, and its other subsidiaries in Texas have stated to representatives of the defendant that up to June 29, 1937 they had not been able to locate in the records of these companies in Texas the original of said contract and supplements thereto, and also stated that they had no knowledge at that time of its then whereabouts and that to their present knowledge they are not in the records of any of said concerns in Texas.

The records of the Central Public Service Company and its subsidiaries, the Gulf Coast Water Company and Central West Water and Power Company, are necessary at the trial of this case, which records should include the minute books, ledgers, journals, stock books, correspondence, and other

records, to show the acquisition of said contract from B. E. Buckman and Company and the consideration therefor, its transfer and consideration therefor to the Central West [fol. 52] Water and Power Company, and the transfer from the latter to Gulf Coast Water Company, and that such contract was a valid and existing contract in effect at the time and prior to the purported sale contract of November 19, 1931 from the Gulf Coast Irrigation Company to the Gulf Coast Water Company, and this contract was never abandoned or abrogated as testified by witnesses at the hearing on June 24, 1937, and that prior to and at the time of the contract of November 19, 1931, now in evidence, the Gulf Coast Water Company actually owned all of the assets purported to be conveyed by said contract. There should be found in the records of these companies the original of said contract of November, 1930, together with the supplements thereto. It is necessary to take the testimony of the officers of this company in Chicago and Madison, Wisconsin and put in evidence the records of these companies, for the reason that the officers of these companies in Texas have stated that the original of these contracts and the supplements thereto are not in their possession in Texas, and have not permitted the representatives of the defendant since the hearing of June 24, 1937 to examine the minute books of the Central Public Service Company and its subsidiaries, and for that reason the defendant is unable definitely to state to the Court what matters can be proven by the minutes of these corporations, but it is believed that the minutes of these corporations, together with the other evidence sought by the defendant, will show that said contract of November, 1930 was not abandoned as testified by plaintiff, but that the proceedings set out in the minutes and contracts introduced in evidence by the plaintiff insofar as they purport or tend to show a new transaction, was a sham and a subterfuge to put into another form a completed transaction in order to avoid the tax that was due on such completed transaction. The records of the Central Public Service [fol. 53] Company and subsidiaries will show that it owned all of the stock of said subsidiaries, that they filed an affiliated income tax return for 1931, and that at the time this group of concerns acquired the assets of the Gulf Coast Irrigation Company and V. L. LeTulle, they owned large amounts of other assets. These records will show also the acquisition of the contract from Buckman and Company and

subsequent assignments and considerations therefor. The books of the Central West Water and Power Company record entries dated as of January 2, 1931 but made between June 30 and November 19, 1931, which reflect the acquisition of the assets of the Gulf Coast Irrigation Company and V. L. LeTulle in accordance with the contract of November, 1930 and the supplements thereto, and also the acquisition of this contract from the Continental Public Service Company, as well as the payments of \$10,000.00 and \$15,000.00 made in January and February, 1931, respectively, on said contract. The books and records of the Gulf Coast Water Company show that the earnings from the properties acquired from the Gulf Coast Irrigation Company and V. L. LeTulle for the year 1931 amounted to over \$160,000.00, which earnings, less certain sums in accordance with the contract of sale, were to be applied on the retirement of bonds Numbers 1 to 15, inclusive.

The books and records of V. L. LeTulle were not produced at the hearing on June 24, 1937, and these if produced will show the receipt of \$10,000.00 on January 22, 1931, and \$15,000.00 on February 10, 1931, by V. L. LeTulle as part payment on said contract of November, 1930 and supplements thereto for the sale of said assets. And also the payments made on the bonds received from the Gulf Coast Water Company in 1931 and 1932, which payments have a material bearing on the fair market value of the bonds when received by the Gulf Coast Irrigation Company. [fol. 54] The records of J. C. Lewis, Trustee, under indenture of bond issue, show the amount received by him from the Gulf Coast Water Company and the amounts disbursed by him to V. L. LeTulle and other holders of bonds distributed by the Gulf Coast Irrigation Company, as payments on principal and interest for the years 1930 to 1935, inclusive, in which latter year the bonds were paid in full.

VIII

In order to establish the above facts, it will be necessary to take the testimony of the following witnesses:

1. V. L. LeTulle, Bay City, Texas—who has in his possession his own records and possibly some of the records of the Gulf Coast Irrigation Company, including the minute book and the original or a copy of the contract of November, 1930. He can identify his personal records, and possibly

some of the records of the Gulf Coast Irrigation Company, and testify as to said transactions.

2. E. L. McDonald, Bay City, Texas—was Secretary of the Gulf Coast Irrigation Company prior to dissolution; has or should have in his possession records of that company including the minute books and said contract, and will be able to testify and identify the various entries in these books in the event that they are produced either by himself or by others.

3. E. J. Crofoot, Bay City, Texas—Vice-President of the Continental Public Service Company, and President of the Gulf Coast Water Company. Was an officer and director of those companies in 1931 and familiar with these various transactions. He is the chief managing officer of the Continental Public Service Company and its subsidiaries, and has in his control and possession the greater part, if not all of the records of these concerns, and should be required [fol. 55] to produce and identify the various records of these concerns and testify as to the transactions.

4. R. G. Wertz, Bay City, Texas—was and is Treasurer of the Continental Public Service Company and its various subsidiaries, and was also one of the bookkeepers and kept part of the books and records of these concerns and particularly the operations of the properties during the year 1931, which were transferred to the Gulf Coast Water Company in November, 1931 and has been connected with these concerns since that date.

5. Jules Ducross, Bay City, Texas—was the bookkeeper of the Gulf Coast Irrigation Company and the Markham Irrigation Company during the years 1928 to 1931, inclusive; and since 1931 has been a bookkeeper for the Continental Public Service Company and its subsidiaries. He will be able to identify the various books and records of these concerns and the entries therein, and testify with respect thereto.

6. B. E. Buckman, Madison, Wisconsin—was and is President of B. E. Buckman and Company, and personally handled the transaction of securing the contract to purchase the assets as stated above from V. L. LeTulle and the Gulf Coast Irrigation Company, and also has personal knowl-

edge of the transfer of this contract to the Continental Public Service Company and will also be able to identify the books and records of his concern, and if in his possession, will be able to produce the original of said contract of sale and supplements thereto.

7. E. C. Holt, Madison, Wisconsin—was Secretary and Treasurer of the Continental Public Service Company and its subsidiaries during the years 1930 to 1933, inclusive, and it is believed will be able to identify many of the records of that concern, particularly the minutes of directors' meet- [fol. 56] ings and possibly other records, and may also have personal knowledge of some of the facts stated above.

8. F. H. Collins, Chicago, Illinois—is at the present time President of the Continental Public Service Company, and is the chief executive officer of that concern, and it is necessary that his testimony be taken in view of the statements made by the officers of that concern in Texas that they do not have in their possession the original of said contract and supplements thereto and do not have in their possession the minute books and all of the other records of the Continental Public Service Company; that such records are in Madison, Wisconsin under the control of said Collins.

9. Jay Samuel Hartt, Madison, Wisconsin—who will produce and identify his appraisal of said assets in 1931, showing that he valued said assets at \$1,300,000.00.

IX

For the reasons above stated, the defendant respectfully shows to the Court that he cannot go to trial without the evidence outlined above in order to present to the Court all the material facts to the transactions involved in this suit, which facts are necessary in order for the Court to reach a correct decision in this case and the defendant believes that these facts have a very material bearing upon the questions at issue.

Wherefore, it is prayed that this hearing be continued to some other date convenient to the Court, in order that the defendant may take the depositions in accordance with the rules of the Court of the witnesses outlined above, and any [fol. 57] other witnesses which the defendant may deem necessary from the facts as developed in the taking of the

depositions of the above witnesses and the examination of said records.

W. R. Smith, Jr., United States Attorney; H. W. Moursund, Assistant United States Attorney; L. L. Gibson, Special Assistant to the Attorney General; J. L. Backstrom, Special Attorney Bureau of Internal Revenue.

Western Union

(Copy)

SAN ANTONIO TEXAS
JUNE 30 1937

JULES DUCROSS
BAY CITY TEXAS

ORDER ENTERED DIRECTING SUBPOENA TO BE ISSUED TO YOU FOR APPEARANCE AT SAN ANTONIO JULY FIFTH CASE LETULLE VERSUS SCOFIELD HAS BEEN RESCINDED STOP YOU MAY DISREGARD SUBPOENA IF SERVED UPON YOU

W R SMITH JR
US ATTORNEY

[File Endorsement omitted.]

[fol. 58] IN UNITED STATES DISTRICT COURT

ORDER DENYING AND OVERRULING DEFENDANT'S MOTION FOR CONTINUANCE

* On the 5th day of July, A. D. 1937, came on to be heard the defendant's motion for continuance filed in this cause on the 5th day of July, 1937, and the court after considering the same is of the opinion that the same should be denied and overruled.

It is, Therefore, Ordered that defendant's motion for continuance filed in this cause on July 5, 1937, be, and the same is hereby, denied and overruled, to which action of the court the defendant in open court excepted.

Entered this 5th day of July, A. D. 1937.

Robert J. McMillan, United States District Judge.

Approved: Homer L. Bruce, W. E. Devant, Attys. for pf.
Entered: Min. Vol. L, page 567.

Filed May 6, 1938.

[fol. 59] IN UNITED STATES DISTRICT COURT

JUDGMENT—Filed April 29, 1938

Be it remembered that on the 24th day of June, 1937, came on to be heard the above numbered and entitled consolidated cause, and came the plaintiff, V. L. LeTulle, by his attorneys; and the defendant, Frank Scofield, United States Collector of Internal Revenue for the First District of Texas, by his attorneys, and all parties announced ready for trial. A Jury having been expressly waived in writing, the matters of law and fact were submitted to the Court. The Court, after hearing the pleadings and a portion of the evidence, under the agreement of counsel for plaintiff and defendant, adjourned the trial to the 5th day of July, 1937, at San Antonio, Texas, and thereupon, on said date, the trial was resumed, and the Court, after hearing the remainder of the evidence and arguments of counsel is of the opinion and finds the facts and the law to be as in the Court's findings of fact and conclusions of law filed in this cause on the 29th day of April, 1938.

In accordance with said findings of fact and conclusions of law, it is ordered, adjudged and decreed that the plaintiff do have and recover judgment against the defendant, Frank Scofield, United States Collector of Internal Revenue for the First District of Texas, for the sum of One Hundred Ten Thousand Two Hundred Thirty-Four and 00/100 Dollars (\$110,234.00), together with interest thereon at the rate of six per cent (6%) per annum, said interest to be computed upon the sum of Forty Thousand Nine Hundred Nineteen and 30/100 Dollars (\$40,919.30) from June 21, [fol. 60] 1934, and upon Sixty-Nine Thousand Three Hundred Fourteen and 70/100 Dollars (\$69,314.70) from June 9, 1934.

It is further ordered that plaintiff recover of defendant all costs in said consolidated cause incurred.

The Court hereby certifies that the defendant acted under the direction of the Commissioner of Internal Revenue in exacting from plaintiff, V. L. LeTulle (as Transferee of the assets of Gulf Coast Irrigation Company), on June 21, 1934, income taxes and interest in the sum of Forty Thousand Nine Hundred Nineteen and 30/100 Dollars (\$40,919.30), and exacting from plaintiff, V. L. LeTulle (individually and as survivor of the community of himself and wife, Mrs. V. L. LeTulle, and as sole heir of his wife),

on June 9, 1934, income taxes and interest in the sum of Sixty-Nine Thousand Three Hundred Fourteen and 70/100 Dollars (\$69,314.70), and that the money so exacted from plaintiff was paid into the Treasury of the United States by the defendant in the performance of his official duty, therefore, no execution shall issue against the defendant, but the amount recovered by the plaintiff shall, upon final judgment, be provided for and paid out of the proper appropriations from the Treasury of the United States as is provided by Section 842 of Title 28, United States Code.

To all of which defendant in open court excepted.

It is the further order of the Court that the defendant, Frank Scofield, United States Collector of Internal Revenue for the First District of Texas, be, and he is hereby, allowed a period of three months from the date of entry of this judgment within which to settle and file his bill of exceptions [fols. 61-63] in said cause. All relief asked by plaintiff other than that specifically granted is hereby denied. (McM.)

Signed this 29th day of April, 1938.

Robert J. McMillan, United States District Judge.

Approved as to form: W. E. Devant, Homer L. Bruce, Attorneys for Plaintiff; W. R. Smith, Jr., United States Attorney; Lester L. Gibson, Special Assistant to the Attorney General, Attorneys for Defendant.

Entered: Min. Vol. L, page 564.

[File endorsement omitted.]

[fol. 64] IN UNITED STATES DISTRICT COURT

Bill of Exceptions and Statement of Evidence—Filed Sept. 23, 1938

Be It Remembered, That on this, June 24th, 1937, the above entitled and numbered cause came on for trial before the Honorable Robert J. McMillan, a United States District Judge in and for the Western District of Texas, at Austin, Texas, and a jury being waived; plaintiff being represented by Mr. Homer L. Bruce, of Houston, Texas, and Mr. W. E. Devant, of Bay City, Texas, and defendant by Lester L. Gibson, Esquire, Washington, D. C., J. L. Backstrom, Esquire, Dallas, Texas, W. R. Smith, of San Antonio, Texas, United States District Attorney for the Western District of

Texas, H. W. Moursund, Esquire, Assistant United States District Attorney of San Antonio, Texas. Whereupon the following testimony was introduced in evidence:

The pleadings were read.

STIPULATION IN CAUSE NO. 1412

Stipulation of Facts

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true for the purpose of this action, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true; the right of either party is hereby reserved to object to the relevency, competency or materiality of any or all the facts so stipulated to be taken as true.

[fol. 65] 1. Plaintiff is and has been at the various dates hereinafter alleged a citizen of the State of Texas, residing in Bay City, Matagorda County, Texas.

2. Defendant, Frank Scofield, is the duly appointed, qualified and acting United States Collector of Internal Revenue for the First District of Texas, having assumed his office on November 21, 1933, and has been Collector continuously from said date. This District includes Matagorda County, Texas, and as such Collector, the defendant was vested with the power and authority to collect taxes upon the income of persons and corporations within said District that were levied and assessed under and by virtue of the Act of Congress designated the Revenue Act of 1928. The defendant is a resident of Austin, Travis County, Texas.

3. Plaintiff's cause of action is to recover from the defendant the amounts of income tax and interest paid by the plaintiff, as transferee of the assets of the Gulf Coast Irrigation Company, a Texas corporation, to the defendant for the fiscal year beginning April 1, 1930, and ending March 31, 1931, and for the fiscal period beginning April 1, 1931, and ending November 21, 1931, with interest from the dates of payment according to law. On or about November 17, 1931, the Gulf Coast Irrigation Company was dissolved and ceased to be a corporation, and its assets were

distrib--ed to plaintiff as the sole stockholder of said corporation. Thereafter, during the year 1934, the Commissioner of Internal Revenue, on his July 6, 1934, list, assessed against V. L. LeTulle, as transferee of the assets of the Gulf Coast Irrigation Company for the fiscal year beginning April 1, 1930, and ending March 31, 1931, and for the fiscal period beginning April 1, 1931, and ending November 21, 1931, income tax and interest as hereinafter set out.

[fol. 66] 4. As required by the provisions of the Revenue Act of 1928, the Gulf Coast Irrigation Company filed with the Collector of Internal Revenue, defendant's predecessor in office, its return of income for the fiscal year beginning April 1, 1930, and ending March 31, 1931, and for the fiscal period beginning April 1, 1931, and ending November 21, 1931, on the 14th day of June, 1931, and on the 18th day of December, 1931, respectively. Photostatic copies of said returns are attached hereto as Exhibits A and A-1, and by reference made a part hereof.

(Photostatic copies of these returns were introduced by the plaintiff but are not copied in full so as not to encumber the record. The return for the period beginning April 1, 1931, and ended November 21, 1931, covered that part of the then current fiscal year of Gulf Coast Irrigation Company up to the date of its dissolution November 21, 1931. The return showed the net income of the Company as being the amount set out in Paragraph VII of plaintiff's petition in Cause No. 1412 and treated the transfer of the assets to Gulf Coast Water Company as a tax free transaction and did not include any amount as profit realized on the sale of the assets to Gulf Coast Water Company. The plaintiff also introduced original letters from the Commissioner of Internal Revenue setting out the changes that the Commissioner made in computing the income tax on the corporation for said period ended November 21, 1931, which changes are the changes set out in Paragraph VII of plaintiff's petition in Cause No. 1412.)

5. Subsequent to the dissolution of said corporation and the transfer of its assets to the plaintiff herein, and during the year 1934, the Commissioner of Internal Revenue assessed the additional tax hereinabove set out against the plaintiff as transferee of said corporation on account of the income of the corporation for said fiscal year and [fol. 67] fiscal period, together with interest thereon, all of

which amounts of additional income tax and interest thereon are as follows:

For the fiscal period beginning April 1, 1931, and ending November 21, 1931:

Principal	-36,422.83
Interest	4,496.47
Total	\$40,919.30

Plaintiff paid said additional income tax and interest, as above set out, to the defendant on or about June 21, 1934.

7. The additional tax for the fiscal period beginning April 1, 1931, and ended November 21, 1931, was due to the addition by the Commissioner of Internal Revenue of \$301,124.04, so that the total income of the corporation for said period upon which the Commissioner computed and assessed said tax was arrived at by him as follows:

Net income as shown on return	\$2,399.54
Profit realised on sale of assets	301,124.04
Total net income	\$303,523.58
Income tax at 12%	36,422.83
Original Assessment	None
Deficiency assessed against and paid by plaintiff	\$36,422.83

8. The Commissioner of Internal Revenue determined the net profits on the transfer by Gulf Coast Irrigation Company to Gulf Coast Water Company in November, 1931. Consideration received by the corporation:

Cash	\$50,000.00
\$150,000 bonds	150,000.00
\$600,000 bonds	500,000.00
Total	\$700,000.00
[fol. 68] Deduct:	
Costs of assets	398,875.96
Profit realized	301,124.04

It is further agreed and admitted that the plaintiff is entitled to have deducted \$40,000.00 commission which was to be paid out of the proceeds of said bonds, said interest having been assigned prior to the sale thereof.

10. During the year 1934 and within the statutory period of limitations, after the payment of said tax and interest plaintiff filed with the defendant at Austin, Texas, his claims for the refund to him of said taxes and interest, separate claims being filed for the fiscal year ended March 31, 1931, and the period ended November 21, 1931. Photostatic copies of said claims for refund are attached hereto as Exhibits C and C-1, and by reference made a part hereof. (These exhibits omitted to avoid encumbering the record. It is agreed that the claims for refund adequately set out all the grounds for refund of the taxes that plaintiff set out in his petition in this cause and on which the court rendered the judgment in favor of plaintiff.) This suit was filed after the expiration of six months from the filing of the said claims for refund, and subsequent to the filing of the suit, the Commissioner of Internal Revenue rejected the said claims.

(Signed) Homer L. Bruce, Attorney for plaintiff.

(Signed) W. R. Smith, Jr., United States Attorney.

(Signed) H. W. Moursund, Assistant United States Attorney.

(Signed) Lester L. Gibson, Special Assistant to the Attorney General, Attorneys for defendant.

[fol: 69] (Endorsements: Filed June 24, 1937. Maxey Hart, Cler., By Joe Steiner, Deputy.

STIPULATION IN CAUSE NO. 1413 (EXHIBIT NO. 7)

[Title omitted]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that the following facts shall be taken as true for the purpose of this action, provided, however, that this stipulation shall be without prejudice to the right of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true; the right of either party is hereby reserved to object to the relevancy, competency or

materiality of any or all the facts so stipulated to be taken as true.

1. Plaintiff is and has been at various dates hereinafter alleged a citizen of the State of Texas, residing in Bay City, Matagorda County, Texas.

[fol. 70] 2. Defendant, Frank Scofield, is the duly appointed, qualified and acting United States Collector of Internal Revenue for the First District of Texas, having assumed his office on November 21, 1933, and has been Collector continuously from said date. This District includes Matagorda County, Texas, and as such Collector, the defendant was vested with the power and authority to collect taxes upon the income of persons and corporations within said District that were levied and assessed under and by virtue of the Act of Congress designated the Revenue Act of 1928. The defendant is a resident of Austin, Travis County, Texas.

3. Plaintiff's cause of action is to recover from the defendant amounts of income taxes for the year 1931 and interest thereon paid to defendant by plaintiff, individually, and by plaintiff, as survivor of a community of himself and wife, Mrs. V. L. LeTulle, and as the sole heir of his wife. Plaintiff and his wife were, during 1931, residents and citizens of Bay City, Texas, and all of their property and income were community property and community income. For said year 1931 plaintiff and his wife filed separate income tax returns with the then Collector of Internal Revenue. Photostatic copies of said returns are attached hereto as Exhibits A and A-1 respectively, and by reference made a part hereof. (The plaintiff introduced in evidence photostatic copies of these returns but they are not copied in full so as to not encumber the record. It is agreed though that the returns of both plaintiff and his wife were identical in all respects, all of their income being community income. Plaintiff also introduced letters addressed to him and his wife from the Commissioner of Internal Revenue setting out the changes that the Commissioner of Internal Revenue made in their returns and on which the additional taxes paid by plaintiff were computed. The statements set forth in [fol. 71] the first paragraph of Paragraph IV of plaintiff's first amended original petition in Cause No. 1413 setting forth the net income of each of plaintiff and his wife as shown by their original returns and the changes made by

the Commissioner and the recomputation of the income of plaintiff and his wife for said year correctly set forth the net income as shown by the original returns and the changes made by the Commissioner.) Thereafter, plaintiff's wife died intestate during the year 1933. The plaintiff was and is her sole heir and became the survivor of the community of himself and his wife. During the year 1934, the Commissioner of Internal Revenue assessed additional income taxes against the plaintiff and his said wife for the year 1931 in the amount of \$35,642.16 in each case, together with interest thereon in each case of \$4,692.07. The said assessment appears on the Commissioner's May 25, 1934, list, number 4, page 1, lines 3 and 4, respectively. Plaintiff, on June 9, 1934, paid to the defendant, Frank Scofield, Collector of Internal Revenue, the said \$35,642.16 additional tax and \$4,692.07 interest assessed on his own income, and on June 9, 1934, plaintiff, as survivor of the community of himself and his wife, and as sole heir of his wife, paid the defendant the said \$35,642.16, additional tax, and \$4,692.07 interest assessed on his wife's income. The administration of the community estate of plaintiff and his wife has been completed, and the plaintiff individually is now the proper party to bring this action and would be entitled to receive all amounts determined by the Court, if any, as a result of the payment of the said additional taxes.

[fol. 72] 4. Said additional tax was due to the following changes made by the Commissioner of Internal Revenue in computing the combined income of plaintiff and his wife:

Net income as shown by returns (being entirely ordinary income and including none as capital gains)		\$82,296.38
Deduct (as included in return):		
(1) Profit on liquidation of Gulf Coast Irrigation Company (included at a higher amount below by the Commissioner)	\$76,358.40	
(2) Dividend reported as ordi- nary income (included in profit on liquidation below)	15,339.78	
		<hr/> 91,698.18
Deficit		<hr/> -9,401.80

Add following changes by Commissioner:

(3) Reduction in loss on ranch	3,245.00	
(4) Reduction in interest paid	6,906.17	
(5) Bad debts disallowed	1,773.73	
(6) Profit on liquidation of Gulf Coast Irrigation Co. (ordinary income)	283,062.28	
(7) Profit on same liquidation (capital gain)	190,147.21	
	<hr/>	485,134.39
Net income		<hr/> \$475,732.59

Plaintiff does not contest the disallowance of items (3), (4) and (5) above.

When plaintiff received the bonds mentioned in numbered paragraph IV, page 4, of the petition there was out-[fol. 73] standing in other parties an interest in them to the extent of \$40,000, being a commission due said parties. In reference to the allegations contained in the seventh paragraph of said numbered paragraph of plaintiff's petition, it is stipulated as follows:

(1) The item in (b) A, cash reported by the plaintiff as an ordinary dividend in his return, should be treated as part of the liquidating dividend on the liquidation of the Gulf Coast Irrigation Company.

(2) In reference to the items in (b) B, C and D, page six of the petition, it is admitted that the sum of \$42,950.42 was the net cash received by plaintiff on said liquidation; that notes receivable in the sum of \$33,421.96 were of the fair market value at the date of receipt of same by plaintiff from the Gulf Coast Irrigation Company of said amount; and that real estate, when received by plaintiff on said liquidation, had a fair market value of \$3,050.

(3) The said above-mentioned items, ordinary dividend, net cash, notes receivable and real estate, were the only cash or property received on the liquidation of said company, except the bonds of that company in the aggregate principal amount of \$750,000 set out on pages three and four of the petition.

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(4) Upon said liquidation of the Gulf Coast Irrigation Company, the plaintiff assumed liabilities of that company as follows:

Accounts payable	\$55,000.00
Ad valorem taxes in dispute	6,787.75
Bryan Jackson account	13,547.86
Revenue stamps	375.26
Income taxes of Gulf Coast Irrigation Company for year ended March 31, 1931	7,963.07
[fol. 74] Income taxes of Gulf Coast Irrigation Company for period ended November 30, 1931	36,422.83

(or whatever amount such taxes are finally determined to be)

Defendant admits that in 1931 bonds numbers one to seven of Gulf Coast Water Company were paid to plaintiff in full, in the principal amount of \$70,000 and that during said year said company likewise paid \$6,648.30 on its bond number 8, held by plaintiff.

6. It is agreed that when plaintiff received the bonds of Gulf Coast Water Company, they were subject to an assignment to other parties of an interest in them of \$40,000, said interest being assigned by way of commission. Also the Gulf Coast Water Company had an option to retire \$600,000 of the bonds for \$500,000 up to September 1, 1932.

7. During the year 1934 and within the statutory period of limitations, after the payment of said tax and interest plaintiff filed with the defendant at Austin, Texas, his claims for refund to him of said additional taxes and interest, separate claims being filed for the tax and interest paid by him, individually, and by him, as transferee of community of himself and wife, and as sole heir of his wife. Photostatic copies of said claims for refund are attached hereto as Exhibits B and B-1, and by reference made a part hereof. (These exhibits omitted to avoid encumbering the record. It is agreed that the claim for refund adequately set out all the grounds for refund of the taxes that plaintiff set out in his petition in this cause and on which the court rendered the judgment in favor of plaintiff.) This suit was filed after the expiration of six months from the filing of the [fol. 75] said claim for refund, and subsequent to the filing

of the suit, the Commissioner of Internal Revenue rejected the said claims.

(Signed) Homer L. Bruce, Attorney for Plaintiff.

(Signed) W. R. Smith, Jr., United States Attorney; (Signed) H. W. Moursund, Assistant United States Attorney; (Signed) Lester L. Gibson, Special Assistant to the Attorney General, Attorneys for Defendant.

The plaintiff then and there introduced in evidence Contract dated November 4, 1931, between Gulf Coast Irrigation Company and Gulf Coast Water Company, which is in words and figures as follows:

EXHIBIT No. 18

"THE STATE OF TEXAS,
County of Matagorda:

This Contract between Gulf Coast Irrigation Company, a Texas corporation with its principal office and place of business in Matagorda County, Texas, party of the first part, hereinafter called 'Irrigation Company', and Gulf Coast Water Company, a Texas Corporation with its principal office and place of business in Matagorda County, Texas, [fol. 76] party of the second part, hereinafter called "Water Company", and V. L. LeTulle, of Matagorda County, Texas, party of the third part, hereinafter called "LeTulle".

Witnesseth:

LeTulle is the owner of all the stock of the Irrigation Company. The Irrigation Company is the owner of certain pumping plants, intakes, pumps, machinery, canals, flumes, laterals, leads, ditches, rights of way of canals and laterals, water rights, personal property, and certain water contracts with its tenants for the year 1931, and a certain contract with the Texas Gulf Sulphur Company and Union Gulf Sulphur Company and prior to the conveyance hereinafter called for to be executed by the Irrigation Company to the Water Company, will be the owner of certain other lands and irrigation properties, all of which said property to be conveyed shall be more particularly described hereafter in Exhibit "A".

Irrigation Company desires to reorganize its interests in said properties so that said properties and business will be transferred to the Water Company in exchange in part for cash and in part for securities of the Water Company hereinafter described, and the said LeTulle desires to reorganize his interest in said properties of the Irrigation Company so that the same will be evidenced in part by the cash hereinafter recited and the said securities of the Water Company.

The Water Company is willing to join in and be a party to said plan of reorganization upon the terms and conditions hereinafter set forth.

Now, Therefore, in consideration of the premises and the mutual and dependent promises herein stated, the parties hereto agree as follows:

[fol. 77]

I

For and in consideration of the sum of Twenty Five Thousand Dollars (\$25,000.00) cash in hand paid by Water Company, receipt of which is hereby acknowledged by Irrigation Company, and Twenty Five Thousand Dollars (\$25,000.00) to be paid and agreed to be paid by Water Company to Irrigation Company upon conveyance to it of the properties hereinafter specifically described in Exhibit "A" by Irrigation Company, and for the further consideration of the mutual covenants hereinafter set forth, Irrigation Company hereby agrees that it will convey the properties described in Exhibit "A" to the Water Company by general warranty deed for the further consideration hereinafter recited.

II

The Water Company in part consideration of the transfer of said properties to it will issue to Irrigation Company its bonds aggregating Seven Hundred Fifty Thousand Dollars (\$750,000.00), Nos. 1 to 15, inclusive, in the sum of Ten Thousand Dollars (\$10,000.00) each, dated September 1st, 1931, payable on or before January 1, 1933, said bonds to contain a provision that they are to be paid in accordance with terms of the escrow agreement hereinafter set out, between the parties hereto and First National Bank of Bay City, Texas; and Nos. 16 to 27, inclusive, in the sum of Fifty Thousand Dollars (\$50,000.00) each, dated September 1st, 1931, No. 16 being payable on or before January

1, 1933, and one bond payable each year serially on or before January 1st of each succeeding year until all are paid on or before January 1, 1944, all bonds to bear interest at the rate of six percent (6%) per annum, payable annually, such interest to be evidenced by coupons attached to each [fol. 78] of the bonds, the first coupon being for interest from September 1st, 1931, until January 1, 1933, and the remainder of said coupons being for one year's interest each. The twelve bonds, Nos. 16 to 27, inclusive, shall contain a provision that the Water Company shall have the option any time within nine (9) months from January 1, 1932, to call them and pay them in full for Five Hundred Thousand Dollars (\$500,000.00) with interest on that sum from September 1st, 1931, to the time of such payment, at the rate of six percent (6%) per annum. Thereafterwards the Water Company shall have the right to call and pay said bonds or any part thereof at any time by giving notice in writing to the Trustee of its intention to pay said bonds or such part of them as it desires, and by paying the full amount of principal and interest due at the time of such call on the bond or bonds to be paid off to the Trustee.

III

A specimen copy of the bond to be executed by the Water Company will be attached hereto and marked Exhibit "B" in the same manner as Exhibit "A". These Bonds shall be secured by a first mortgage evidenced by a deed of trust on all the properties to be conveyed to Water Company as provided in paragraph 1 hereof. J. C. Lewis of Matagorda County, Texas, shall be Trustee in the deed of trust. A specimen of the deed of trust to be executed by the Water Company will be attached hereto and marked Exhibit "C" in the same manner as Exhibit "A".

IV

The Water Company under this plan of reorganization shall treat the properties as having been acquired by it on the 1st day of January, 1931, and the Water Company shall be entitled to all the revenues that have accrued and that [fol. 79] shall hereafter accrue to the Irrigation Company or to LeTulle, or to the Water Company from the operation of the properties described in Exhibit "A" from January 1, 1931. Except as hereinafter and hereinbefore provided, the Water Company shall also be liable for all expenses

of operating said properties and business during the year 1931, which shall include all expenses, charges, claims and liabilities of every kind and character whatsoever, and all taxes of every kind of Irrigation Company, and/or LeTulle in so far as such taxes arise out of the operation of the properties owned by him and conveyed to Irrigation Company, in the year 1931, and/or Water Company, Federal, State, County, or otherwise for said year, except Federal taxes, if any, upon Irrigation Company, and/or LeTulle, on account of the transfer of said properties to Water Company under this contract. Provided, however, that if the income tax assessed to or paid by LeTulle upon the operations of the property by him transferred to Irrigation Company shall exceed the amount of tax which a corporation would have to pay thereon, the tax to be paid by the Water Company shall not exceed the tax which would have been assessed upon such operations by a corporation, and provided, further, that Water Company does not assume, and expenses of operation shall not include, any liability for claims or demands, if any, arising by reason of fraud, misrepresentation, wilful misconduct or wilful negligence occurring during the operation of any of the properties described in Exhibit "A" during the year 1931 by the Irrigation Company, and/or LeTulle.

Irrigation Company and LeTulle agree that from and after January 1, 1931, up to and including the date of delivery of instrument of transfer of said properties from the Irrigation Company to the Water Company that the business of the Irrigation Company will be carried on in [fol. 80] the regular, ordinary and usual manner as heretofore; that the salaries of employees and officers have not and will not be increased, that no bonuses have been or will be paid to officers or directors, that no dividends either cash or stock have been or will be declared to stockholders, and that said Irrigation Company will have maintained its status as a corporation legally entitled to do business in the State of Texas; that all of its franchise taxes will have been paid.

The Irrigation Company is now in the process of harvesting and marketing its 1931 rice crop. All moneys that have been received by it or that may be hereafter received by it or the Water Company from the 1931 rice crop, or from any other source on account of operations for the year 1931 shall be applied as follows:

(a) To the payment of the operating expenses of the Irrigation Company, and/or the Water Company for the year 1931 upon the joint approval of V. L. LeTulle and E. J. Crofoot or the then President of the Water Company. A statement of the operating expenses that have been incurred up to the time of the execution of this contract to be prepared and agreed upon by V. L. LeTulle and E. J. Crofoot and attached hereto marked Exhibit "D" in the same manner as Exhibit "A".

(b) Any expenses incurred by the Irrigation Company or the Water Company after the execution of this contract, shall be paid out of these revenues upon the joint approval of E. J. Crofoot and V. L. LeTulle.

(c) After the payment of the expenses provided in subparagraphs (a) and (b) aforesaid, then all of the remainder of net revenues from the 1931 operations of these properties [fol. 81] after setting aside the One Thousand Dollar (\$1,000.00) balance provided for in paragraph V hereof, shall be applied to the payment of bonds Nos. 1 to 15, inclusive, aforesaid, maturing on or before January 1, 1933.

(d) All payments for 1931 operating expenses of the Irrigation Company and/or LeTulle and/or Water Company as herein provided for and all payments to be made pursuant to this paragraph IV shall be made only from the proceeds of the 1931 operation of the property described in Exhibit "A" until January 1, 1933, provided, however, that nothing in this sub-paragraph (d) contained shall relieve Water Company from Liability for the expenses and obligations assumed by it under this paragraph IV which, unless paid prior thereto in the manner herein contemplated, shall be paid not later than January 1, 1933.

V

All revenues which have accrued to Irrigation Company, or which may hereafter accrue to the Water Company from the operation of the properties set forth in Exhibit "A" for the year 1931 crop shall be deposited in the First National Bank of Bay City, Texas, in a special Trustee account entitled "Gulf Coast Water Company and V. L. LeTulle Escrow Trust", and be paid out only upon the joint signature of V. L. LeTulle, his agent, executor, or administrator, and E. J. Crofoot, or the then President of the

Water Company. This escrow trust account shall be applied first to the payment of the operating expenses referred to in paragraph No. IV (a) hereof, provided, however, that at no time prior to January 1, 1932, shall this account be [fol. 82] less than One Thousand Dollars (\$1,000.00) so as to provide for the current operating expenses set out in paragraph No. IV (b) hereof. This escrow trust account shall next be applied to the payment of the operating expenses set forth in said paragraph No. IV (b). This escrow trust account shall next be applied to the retirement of bonds Nos. 1 to 15, inclusive, which bonds shall be deposited in escrow with the First National Bank of Bay City. The said bank shall deliver said bonds as they are paid to E. J. Crofoot or the Water Company. When bonds Nos. 1 to 15 have been retired pursuant to the provisions of this paragraph, the escrow trust account shall be closed and any balance in said account and all revenue thereafter shall belong to the Water Company to be deposited when and where it designates. This escrow shall be without cost to the Water Company, and shall not be deducted from the aforementioned revenues. Whenever One Thousand Dollars (\$1,000.00) or any multiple thereof shall be available in accordance with the terms hereof for the payment set forth in sub-paragraph (c) of paragraph IV such available sums shall be paid forthwith to the then owner of bonds Nos. 1 to 15, inclusive, and interest upon such proportionate amount so paid shall cease and determine from the date of payment and a notation shall be made and attached to the bonds so held in escrow and proper credit given whenever any bond is paid.

Upon the execution of this contract, and when a copy of same shall have been lodged with the First National Bank of Bay City, Texas, and accepted by said bank as to the escrow provision hereof, the bank is hereby authorized and [fol. 83] requested to notify all water tenants of the Irrigation Company, the Farmers Storage Company, and any and all mills and warehouses who may purchase rice from water tenants of the Irrigation Company upon which rental is due of the right and duty of the bank to collect and hold these rentals in said trust capacity. And all payments of these rentals shall thereafterwards be made at said bank until the termination of the escrow agreement, in accordance with the provisions of this contract. When the escrow trust is closed as herein provided for, the First National Bank of

Bay City, Texas, shall thereupon so notify all water tenants of the Irrigation Company and any and all mills and warehouses who may purchase rice from water tenants of the Irrigation Company upon which rental is due that its right of collection and holding said rentals in its trust capacity has ceased and determined and that further payment shall be made to the Water Company or its order.

VI

The Water Company shall not assume or be liable for any of the debts or other obligations of the Irrigation Company or V. L. LeTulle, incurred or arising from operations prior to January 1, 1931, except this item, to-wit: A concern called the Byron Jackson Company has a claim against the Irrigation Company for an alleged balance due on a contract for certain equipment dated October 23, 1929, which claim is disputed by the Irrigation Company. It is for approximately Fourteen Thousand Dollars (\$14,000.00). The Water Company shall assume this claim with the privilege of paying it or litigating it as it sees fit and for such assumption [fol. 84] shall have a credit upon the first fifteen bonds described above of Thirteen Thousand Five Hundred Forty Seven and 86/100 Dollars (\$13,547.86).

VII

The properties referred to in paragraph No. I hereof which are to be conveyed by the Irrigation Company and LeTulle to the Water Company will be conveyed by the description which will be contained in Exhibit "A" to be attached hereto. Upon a further check of these descriptions it may be determined that they do not adequately describe the property referred to in the preamble of this contract. If it should be determined by the Water Company that such is the case, then the Water Company shall prepare at its expense a correction general warranty deed or deeds so as to include and more accurately describe all of said properties or parts thereof, and such deed or deeds shall be executed by the Irrigation Company.

VIII

It is understood and it is a part of the consideration for the execution of these presents that neither LeTulle nor the Irrigation Company will engage directly or indirectly in

the irrigation business in Wharton or Matagorda Counties, Texas, for a period of thirty (30) years from the date hereof, unless either of said parties repurchase or otherwise acquire the ownership of the properties described in Exhibit "A", in which event the party so acquiring said property shall be relieved from this covenant.

It is expressly understood that said LeTulle shall not [fol. 85] operate an irrigation plant for the purpose of supplying the lands now owned by him or which he may hereafter acquire with water or for the supplying of any of his tenants with water for a like period of thirty (30) years from the date hereof.

These covenants shall suitably be engrossed in the deeds of conveyance from Irrigation Company to Water Company.

IX

This contract is to be wholly performed in Matagorda County, Texas.

X

The Irrigation Company and LeTulle agreed that all income taxes of the Irrigation Company and LeTulle arising prior to January 1, 1931, and any and all income taxes, if any, arising out of the transfers of the property herein provided for, will be promptly paid when due, unless contested in good faith, and in such case payment will be made on final determination, and said Irrigation Company and LeTulle will hold the Water Company harmless from any and all liability therefrom.

XI

LeTulle and the Irrigation Company agree to hold the Water Company harmless from any and all liability for any and all taxes of whatsoever nature that have accrued against the properties set forth in Exhibit "A" prior to January 1, 1931.

[fol. 86]

XII

LeTulle and the Irrigation Company shall hold and save harmless the Water Company from any and all liability that might come, grow or arise by reason of any pending litigation against said Irrigation Company, LeTulle, or:

Markham Irrigation Company
 Texas Irrigation Company
 Moore-Cortez Canal Company
 Collegeport Canal Company
 Collegeport Irrigation Company
 Lane City Canal Company
 Bay City Canal Company
 Matagorda Canal Company
 Colorado Canal Company
 Security Canal Company
 Gravity Canal Company
 Gravity Irrigation & Power Company
 Peyton Creek Irrigation District
 Sexton Rice and Irrigation Company
 Bay City Rice and Irrigation Company
 Central Irrigation Company
 Southern Irrigation Company
 Nile Valley Canal Company
 Consolidated Canal Company
 Tres Palacios Rice and Irrigation Company
 Bay Prairie Irrigation Company

or any litigation that may hereafter arise based upon any claims, demands or causes of action which have accrued prior to January 1, 1931.

XIII

This contract shall not become in anywise operative unless and until Exhibits "A", "B", "C" and "D" have been hereto attached, and have been first approved by LeTulle, his agent, executor or administrator; and E. J. Crofoot, or the then President of the Water Company.

[fol. 87]

XIV

LeTulle shall join in all deeds, correction deeds, conveyances and transfers to be executed by Irrigation Company hereunder for the purposes of joining personally with the Irrigation Company in all warranties to be contained in all such deeds, correction deeds, conveyances or transfers, and for the purpose of evidencing the agreements set forth in paragraph VIII hereof.

XV

LeTulle agrees that he will cause the Irrigation Company to perform and carry out all the obligations of Irriga-

tion Company hereunder, subject to the terms and provisions of this contract.

XVI

Irrigation Company shall pay the expenses of printing or otherwise preparing the said bonds to be issued by Water Company and all federal stamp taxes in connection therewith, all recording fees for recording the Trust Indenture and all Trustee's fees and expenses arising prior to a completed default.

XVII

The provisions of this contract shall inure to the benefit of and be binding upon all of the parties hereto, and their respective heirs, successors, executors, administrators and assigns.

In Witness Whereof, the parties hereto have duly executed this contract in a number of original copies, each of which shall constitute an original, but all of which shall constitute only one contract, this 4th day of November, 1931.

Gulf Coast Irrigation Company. By V. L. LeTulle,
President—First Party. (Seal.)

[fol. 88] Attest: — — —, Secretary, Gulf Coast Water Company, by E. J. Crofoot, President—Second Party. (Seal.)

Attest: R. G. Wert, Secretary V. L. LeTulle, Third Party.

The First National Bank of Bay City, Texas, to evidence its consent and acceptance of the escrow provisions herein contained has caused these presents to be executed in its corporate name by its

this 4th day of November, A. D. 1931.

The First National Bank of Bay City (Texas), by
J. C. Lewis, Its Vice President.

THE STATE OF TEXAS,
County of Matagorda.

Before Me, the undersigned authority, on this day personally appeared V. L. LeTulle known to be to be the person whose name is subscribed to the foregoing instrument, and acknowledged to me that he executed the same as the act and deed of the Gulf Coast Irrigation Company for the purposes and consideration therein expressed, and in the capacity therein recited.

Given under my hand and the official seal of my office, this 4th day of November, A. D. 1931.

Lola E. Williamson, Notary Public in and for Matagorda County, Texas. (Seal.)

[fol. 89] THE STATE OF TEXAS,
County of Matagorda:

Before Me, the undersigned authority, on this day personally appeared E. J. Crofoot known to me to be the person whose name is subscribed to the foregoing instrument acknowledged to me that he executed the same as the act and deed of the Gulf Coast Water Company for the purposes and consideration therein expressed, and in the capacity therein recited.

Given under my hand and the official seal of my office this 4 day of November, A. D. 1931.

Lola E. Williamson, Notary Public in and for Matagorda County, Texas. (Notary Seal.)

(Seal of Gulf Coast Irrigation Company.)

THE STATE OF TEXAS,
County of Matagorda:

Before Me, the undersigned authority, on this day personally appeared V. L. LeTulle known to me to be the person, whose name is subscribed to the foregoing instrument and acknowledged to me that he executed the same for the purposes and consideration therein expressed.

Given under my hand and seal of office this 4th day of November, A. D. 1931.

Lola E. Williamson, Notary Public in and for Matagorda County, Texas. (Seal.)

THE STATE OF TEXAS,
County of Matagorda:

Before Me, the undersigned authority, on this day personally appeared J. C. Lewis known to me to be the person whose name is subscribed to the foregoing instrument, and [fol. 90] acknowledged to me that he executed the same as the act and deed of The First National Bank of Bay City, for the purposes and consideration therein expressed, and in the capacity therein recited.

Given under my hand and the official seal of my office
this 4th day of November, A. D. 1931.

Lola E. Williamson, Notary Public in and for Mata-
gorda County, Texas. (Seal.)

Endorsed) (In pencil) Letulle's copy.

Contract Entered Into by and Between Gulf Coast Irrigation Company, Gulf Coast Water Company and V. L. Letulle.

(Note: In reference to the exhibits attached to the Contract above, the following notations are made):

EXHIBIT "A" TO CONTRACT

Exhibit A is not copied in the Bill of Exceptions in order to shorten the record.

It consisted of a detailed description of all the irrigation systems and lands and personal property of Gulf Coast Irrigation Company, except cash on hand, notes receivable of the value of \$33,421.96, and real estate of a value of \$3,050.

EXHIBIT "B" TO CONTRACT

Exhibit B was the form of bond to be executed which is the same as the form of bond set forth in the mortgage hereinafter set out in this Bill of Exceptions.

EXHIBIT "C" TO CONTRACT

Exhibit C was the specimen of the mortgage that was later executed and set forth in full hereinafter in the Bill of Exceptions.

Exhibit "D" to contract is in words and figures as follows, to-wit:

[fol. 91]

"EXHIBIT 'D' TO CONTRACT

Gulf Coast Irrigation Company,

Bay City, Texas

Income Statement Jan. 1, 1931 to Oct. 31, 1931.

Income:

Water	T. G. S. Co.	\$19,583.30
"	Farmers—Collected	94,096.51
"	" —Uncollected	215,738.55
"	1/5 volunteer crop uncollected	1,613.59
S	Surveying charges	1,070.20
	Miscellaneous income	455.22
		<hr/>
		\$332,557.37

Deductions:

Automobile Expenses	\$2,709.22	
Canals and Laterals Expense	13,103.12	
Electric Plant No. 1, Expense	13,153.10	
Electric Plant No. 2 Expense	32,491.19	
Electric Plant No. 3 Expense	52,873.49	
Insurance	179.30	
Interest	1,141.67	
Legal Expense	1,666.62	
Miscellaneous op. Expns.	1,602.20	
Peyton Creek op. Expense	261.44	
Rent	614.20	
Salaries	12,233.33	
Surveying expense	2,414.40	
Losses	562.37	
Taxes paid	264.19	
Taxes accrued	5,162.01	140,431.85
		<hr/>
Net Income		\$192,125.52

Ok V. L. LeTulle.

Ok E. J. Crofoot".

[fol. 92] The plaintiff then and there introduced in evidence the original minutes of the Gulf Coast Irrigation Company, (same being marked Exhibit No. 26 by the reporter) and which is in words and figures as follows, to-wit:

EXHIBIT No. 26

**"Gulf Coast Irrigation Company
Agreement for the Holding of a
Special Meeting of Stockholders**

We, the undersigned, being the holders of all of the issued and outstanding shares of the capital stock of Gulf Coast Irrigation Company, a corporation organized under the laws of the State of Texas, do hereby agree that a meeting of the stockholders may be held at the office of the corporation, Bay City, Texas, at any time during the day of November 7th, 1931, for the purpose of considering and acting upon any and all matters of any sort that may be brought before the meeting incident to the business and affairs of this corporation, including particularly, without limiting the generality of the foregoing agreement:

1. For the purpose of authorizing and voting upon a proposed amendment to the charter of this corporation increasing its capital stock from One Hundred Thousand Dollars (\$100,000.00), divided into one thousand (1000) shares of the par value of One Hundred Dollars (\$100.00) per share, to Two Hundred Sixty Six Thousand Dollars (\$266,000.00) divided into two thousand six hundred sixty (2,660) shares of the par value of One Hundred Dollars (\$100.00) per share, and defining the kind and classes of said stock.

2. For the purpose of authorizing and approving a proposed plan of reorganization of the interests of this corporation in the properties and business owned by it.

[fol. 93] 3. For the purpose of transacting any and all other business pertaining to the affairs of the corporation which may properly come before the meeting.

Dated November 7th, A. D., 1931.

V. L. LeTulle, Louis LeTulle, Sam V. LeTulle, J. C. Lewis, E. L. McDonald.

GULF COAST IRRIGATION COMPANY

Minutes of Special Meeting of Stockholders

A special meeting of the stockholders of Gulf Coast Irrigation Company, a Texas corporation, was held at the office

of the Company, Bay City, Texas, on the 7th day of November, 1931, at 3:30 o'clock P. M., pursuant to written waiver of notice signed by all of the stockholders fixing said time and place as follows:

Said meeting to be held at the office of the Gulf Coast Irrigation Company at 3:30 P. M., November 7th, A. D. 1931.

Mr. V. L. LeTulle, President of the Company, was chosen and acted as chairman of the meeting. Mr. E. L. McDonald, Secretary of the Company, was chosen and acted as Secretary of the meeting. Upon call of the roll of stockholders it was found that all of the one thousand (1000) shares of the issued and outstanding stock of the Company was represented at said meeting as follows:

Name	No. of Shares	How represented
V. L. LeTulle	995	In person.
Louis LeTulle	1	In person.
Sam V. LeTulle	1	In person.
E. L. McDonald	1	In person.
J. C. Lewis	1	In person.

[fol. 94] The agreement for the meeting and waiver of notice thereof was presented, approved and ordered filed in the Minute Book of the Company.

The Chairman stated that since all of the issued and outstanding stock of the Company was represented at the meeting, the same was duly organized and ready for transaction of business.

Thereupon, the chairman presented for consideration a proposed amendment to the charter of the Company authorizing an increase in the capital stock of the Company from One Hundred Thousand Dollars (\$100,000.00) divided into one thousand (1000) shares of the par value of One Hundred Dollars (\$100.00) each, to Two Hundred Sixty Six Thousand Dollars (\$266,000.00) divided into two thousand six hundred sixty (2,660) shares of the par value of One Hundred Dollars (\$100.00) each, and defining the classes of stock of the Company.

Upon motion duly made, seconded and unanimously carried, it was

Resolved, that the capital stock of this corporation be increased from One Hundred Thousand Dollars (\$100,000.00) divided into one thousand (1000) shares of the par value of One Hundred Dollars (\$100.00) per share, to Two

Hundred Sixty Six Thousand Dollars (\$266,000.00) divided into two thousand six hundred sixty (2,660) shares of the par value of One Hundred Dollars (\$100.00) per share, such stock to be of the kind and classes hereinafter in these resolutions specified; and

Resolved further, that Article VI of the charter of this corporation be amended so that the same will hereafter read as follows:

[fol. 95] 'Article VI. The authorized capital stock of this corporation shall be Two Hundred Sixty Six Thousand Dollars (\$266,000.00) to be divided into twenty six hundred sixty (2660) shares of the par value of One Hundred Dollars (\$100.00) per share, all of one class, to-wit, common stock;' and

Resolved Further, that the directors of this corporation be and they hereby are authorized, empowered and instructed to execute the foregoing amendment and cause the same to be filed with the Secretary of State of the State of Texas, and to take such other and further action as may be necessary or proper to make said amendment effective; and

Resolved Further, that the directors be and they hereby are authorized to obtain subscriptions for such increased stock and to issue the same for money paid, labor done or property actually received, and that the stockholders hereby waive and relinquish any and all preemptive and preferential rights to subscribe for such increased stock.

The chair then stated to the meeting that it had been proposed that the company reorganize its interests in the properties owned and held by it and in the business carried on by it, by exchanging all of its properties and business for Fifty Thousand Dollars (\$50,000.00) in cash and Seven Hundred Fifty Thousand Dollars (\$750,000.00) in principal amount of First Mortgage 6% Serial Gold Bonds of Gulf Coast Water Company, a Texas corporation. He stated further that both Gulf Coast Water Company and V. L. LeTulle, principal holder of the stock of this corporation, had consented to be parties to the reorganization, Mr. LeTulle desiring also to reorganize his interest in the properties and business of the company. The contract and agreement evidencing the plan of reorganization and the [fol. 96] exhibits thereto attached were submitted and read to the meeting. After discussion, upon motion duly made, seconded, and unanimously carried, it was

Resolved, that Gulf Coast Irrigation Company reorganized its interest in the properties and assets owned by it and in its business, by the exchange and transfer of all of its properties, assets and business for Fifty Thousand Dollars (\$50,000.00) in cash and Seven Hundred Fifty Thousand Dollars (\$750,000.00) in principal amount of the First Mortgage 6% Serial Gold Bonds of Gulf Coast Water Company, pursuant to the plan of reorganization and contract submitted to this meeting: and

Resolved Further, that the said plan of reorganization and contract, be and the same hereby are approved, ratified and confirmed in all respects, and the acts of the President and Secretary of this corporation, respectively, in entering into, executing and delivering said contract in the name and behalf and under the corporate seal of this corporation be and the same hereby are approved, ratified and confirmed, and said contract is in all things adopted as the contract, agreement and obligation of this corporation; and

Resolved Further, that the stockholders hereby approve, authorize and sanction the exchange and transfer of all of the properties, assets and business of this corporation for the sum of Fifty Thousand Dollars (\$50,000.00) cash and the First Mortgage 6% Serial Gold Bonds of Gulf Coast Water Company in the principal amount of Seven Hundred Fifty Thousand Dollars (\$750,000.00), and do hereby authorize and direct the Board of Directors and the President or any Vice President, and the Secretary, or any Assistant Secretary, of this corporation, to do and perform all acts and things and to execute in the name and behalf and under the corporate seal of this corporation, such instruments of [fol. 97] conveyance, transfer and exchange, as may be necessary or proper in order to comply with and carry out said plan of reorganization and contract, and to effect the exchange of said properties, assets and business with Gulf Coast Water Company, upon substantially the terms and conditions set forth in said plan of reorganization and contract; and

Resolved Further, that all acts done and performed, and hereafter done and performed, and all instruments executed, or hereafter executed, by the officers of this corporation, pursuant to and in carrying out said plan of reorganization and contract upon substantially the terms and conditions therein and herein set forth and specified, be and the

same hereby are approved, ratified, confirmed and sanctioned in all respects; and

Resolved Further, that the Directors and officers of this corporation are hereby authorized and directed promptly upon the completion of said transfer and conveyance of said properties, assets and business to Gulf Coast Water Company and receipt of said Fifty Thousand Dollars (\$50,000.00) in cash, Seven Hundred Fifty Thousand Dollars (\$750,000.00) of said First Mortgage 6% Serial Gold Bonds to be received by this corporation in exchange for said properties, assets and business, to distribute said cash and bonds to the stockholders of this corporation pro rata in proportion to their holdings of stock in this corporation; and

Resolved Further, that upon the completion of said transfer of the properties, assets and business of this corporation to Gulf Coast Water Company and the distribution of said cash and bonds to the stockholders of this corporation, all necessary and proper steps be taken legally to dissolve this corporation and terminate its existence and that the President and Directors at the time of this corporation's dissolution, as liquidating Trustees, proceed as promptly as possible to settle the affairs of this corporation and when all debts and liabilities, if any, of this corporation have been fully paid, satisfied and discharged, that they distribute the remainder of the assets, if any, of this corporation among the holders of the stock of this corporation, distributing to each such stockholder his proportionate share thereof according to the number of shares of stock held by him in this corporation.

The chairman thereupon stated that there was no further business to come before the meeting.

Thereupon, upon motion duly made, seconded and unanimously carried, it was

Voted, to adjourn.

V. L. LeTulle, Chairman.

A True Record. E. L. McDonald, Secretary.

Gulf Coast Irrigation Company

Minutes of Special Meeting of Board of Directors

A special meeting of the Board of Directors of Gulf Coast Irrigation Company, a Texas corporation, was held on the

7th day of November, A. D. 1931 at 4:00 o'clock P. M., at the office of the Company, Bay City, Texas, pursuant to a written waiver of notice signed by all of the members of the Board of Directors fixing said time and place as follows:

Meeting to be held at the office of the Gulf Coast Irrigation Company on the 7th day of November, A. D. 1931, at [fol. 99] any time after the meeting of the Stockholders of said Corporation has been held and adjourned.

Gulf Coast Irrigation Company

Waiver of Notice of Meeting of Directors

We, the undersigned, being all of the members of the Board of Directors of Gulf Coast Irrigation Company, a corporation organized under the laws of the State of Texas, do hereby agree that a meeting of the Directors may be held at the office of the corporation, Bay City, Texas, at any time during the day of November 7th, A. D. 1931, for the purpose of considering and acting upon any and all matters of any sort which may be brought before the meeting incident to the business and affairs of this corporation, including particularly without limiting the generality of the foregoing agreement:

1. For the purpose of authorizing and voting upon a proposed amendment to the charter of this corporation increasing its authorized capital stock from One Hundred Thousand Dollars (\$100,000.00) divided into one thousand (1000) shares of the par value of One Hundred Dollars (\$100.00) per share to Two Hundred Sixty Six Thousand Dollars (\$266,000.00) divided into two thousand six hundred sixty (2,660) shares of the par value of One Hundred Dollars (\$100.00) per share, and defining the kinds and classes of said authorized capital stock.

2. For the purpose of authorizing and approving a proposed plan of reorganization of the interests of this corporation in the properties and business owned and carried on by it.

[fol. 100] 3. For the purpose of transacting any and all other business pertaining to the affairs of the corporation which may come before the meeting.

Dated November 7th, A. D., 1931.

V. L. LeTulle, Louis LeTulle, E. L. McDonald, J. C. Lewis, Sam V. LeTulle.

There were present at said meeting the following Directors:

V. L. LeTulle, Louis LeTulle, Sam LeTulle, E. L. McDonald, J. C. Lewis,

being all of the members of the Board of Directors of the corporation.

Mr. V. L. LeTulle, President of the corporation presided as chairman of the meeting, and Mr. E. L. McDonald, Secretary of the Company, acted as Secretary of the meeting. The waiver of notice and agreement for the holding of the meeting was examined, approved and ordered inserted in the Minute Book of the Company.

The chairman stated that since all of the members of the Board of Directors were present the meeting was duly organized and ready for the transaction of business. Thereupon the Secretary presented and read to the meeting resolutions adopted at a special meeting of the stockholders of the corporation held at an earlier hour on this date, amending the charter of this corporation so as to increase the authorized capital stock of the corporation from One Hundred Thousand Dollars (\$100,000.00) divided into the thousand [fol. 101] and (1000) shares of the par value of One Hundred Dollars (\$100.00) per share, to Two Hundred Sixty Six Thousand Dollars (\$266,000.00), divided into two thousand six hundred sixty (2,660) shares of the par value of One Hundred Dollars (\$100.00) per share, all of one class, to-wit, common stock. The chairman stated it was in order for the Directors to amend the charter of the corporation accordingly.

Upon motion duly made, second- and unanimously carried, it was

Resolved, that the charter of this corporation be amended so that Article VI thereof shall hereafter read as follows:

"Article VI. The authorized capital stock of this corporation shall be Two Hundred Sixty Six Thousand Dollars (\$266,000.00), to be divided into two thousand six hundred sixty (2,660) shares of the par value of One Hundred Dollars (\$100.00) per share, all of one class, to-wit: common stock."

Thereupon the chairman stated to the meeting that all of the increased capital stock had been subscribed for by V. L.

LeTulle, who had agreed to pay therefor the sum of One Hundred Sixty Six Thousand Dollars (\$166,000.00), such payment to be made in property to be conveyed and heretofore conveyed to the Company of the fair and reasonable value of the sum above specified. There was presented to the meeting the subscription agreement of Mr. LeTulle.

Upon motion duly made, seconded and unanimously carried, it was

Resolved, that the subscription agreement presented to this meeting be and the same hereby is approved and the sale of the stock of this corporation in the amount therein set forth, for the sum of One Hundred Sixty Six Thousand [fol. 102] Dollars (\$166,000.00) in property, be and the same hereby is authorized and approved; and

Further Resolved, that the proper officers of this corporation be and they hereby are authorized and directed to issue to V. L. LeTulle the number of shares of such increased stock subscribed for by him.

The chairman then stated to the meeting that it had been proposed that the Company reorganize its interests in the properties owned and held by it, and in the business carried on by it, by exchanging all of its properties and business for Fifty Thousand Dollars (\$50,000.00 in cash and Seven Hundred Fifty Thousand Dollars (\$750,000.00) in First Mortgage 6% Serial Gold Bonds of Gulf Coast Water Company, a Texas corporation. He stated further that both Gulf Coast Water Company and V. L. LeTulle, principal holder of the stock of this corporation, had consented to be parties to the reorganization, Mr. LeTulle desiring also to reorganize his interest in the properties and business of the Company. The Secretary then presented to the meeting resolutions adopted at the stockholders' meeting with reference to said plan of reorganization and under which the stockholders approved, ratified and sanctioned the same in all respects, which resolutions were adopted at a meeting of the stockholders held at an earlier hour on this date. The contract and agreement evidencing the plan of reorganization and the exhibits thereto attached were also submitted and read to the meeting. After discussion, upon motion duly made, seconded and unanimously carried, it was

Resolved, that Gulf Coast Irrigation Company reorganize its interest in the properties and assets owned by it and in its business by the exchange and transfer of all of its properties, assets and business for Fifty Thousand Dollars

(\$50,000.00) in cash and Seven Hundred Fifty Thousand Dollars (\$750,000.00) in principal amount of First Mort-[fol. 103] gage 6% Serial Gold Bonds of Gulf Coast Water Company, pursuant to the plan of reorganization and contract submitted to this meeting; and

Resolved Further, that the Board of Directors of this corporation hereby approves, ratifies, confirms and sanctions in all respects the said plan of reorganization and contract, and the acts of the President and Secretary of this corporation, respectively, in entering into, executing and delivering said contract in the name and behalf and under the corporate seal of this corporation, said contract being hereby adopted as the contract and obligation of this corporation; and

Resolved Further, that the President or any Vice-President, and the Secretary or any Assistant Secretary, be and they hereby are authorized, empowered, and directed, to do and perform any and all acts and things necessary or required in order to carry into effect said plan of reorganization and carry out the terms and provisions of said contract, upon substantially the terms and conditions therein set forth, and to execute and deliver any and all instruments of conveyance, transfer and exchange in the name and behalf of and under the corporate seal of this corporation, which are necessary and proper in order to carry out and consummate said plan of reorganization and contract in accordance with the terms and provisions thereof; and

Resolved Further, that the Board of Directors does hereby approve, authorize and sanction the exchange and transfer of all of the properties, assets and business of this corporation with and to Gulf Coast Water Company in exchange for the sum of Fifty Thousand Dollars (\$50,000.00) cash and the First Mortgage 6% Serial Gold Bonds of Gulf Coast Water Company in the principal amount of Seven Hundred Fifty Thousand (\$750,000.00) and does hereby ratify, confirm and sanction all acts and things done [fol. 104] and performed or hereafter done and performed by the proper officers of this corporation in carrying out and consummating said plan of, reorganization, exchange and transfer authorized hereby.

The chairman stated that the next business to be considered and acted upon was the declaration of a dividend. Thereupon the Treasurer of the corporation submitted to the meeting a statement of the Company, showing that there

were undivided profits and surplus sufficient to permit the declaration and payment of a cash dividend upon the stock of the Company in the sum of Fifteen Thousand Three Hundred Thirty-nine & 78 /100 Dollars (\$15,339.78). The statement of the Treasurer having been determined to be correct, upon motion duly made, seconded, and unanimously carried, it was

Resolved, that the Board of Directors do hereby declare and authorize the payment of a dividend upon the capital stock of this corporation in the total sum of Fifteen Thousand Three Hundred Thirty-nine & 78/100 (\$15,339.78), the same to be paid in cash out of the undivided profits and surplus of this corporation, and to be paid to the holders of the shares of capital stock of this corporation proportionately and ratably according to the number of shares held by each, and that the proper officers are hereby authorized and directed to pay said dividend forthwith, and for that purpose to execute and deliver the check or checks of this corporation in the amounts due to the shareholders, respectively.

The chairman thereupon stated that there was no further [fol. 105] business to come before the meeting, and upon motion duly made, seconded, and unanimously carried, it was

Voted, to adjourn.

V. L. LeTulle, Chairman.

A True Record: E. L. McDonald, Secretary.

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Gulf Coast Irrigation Company

Minutes of Special Meeting of Directors

A special meeting of the Board of Directors of Gulf Coast Irrigation Company, a Texas corporation, was held at the office of the Company, Bay City, Texas, on the 18 day of November, A. D. 1931, at 10 o'clock, A. M., pursuant to written waiver of notice signed by all of the Directors fixing said time and place as follows:

at the office of Gulf Coast Irrigation Company
at 10.00 o'clock A M November 18th 1931

Gulf Coast Irrigation Company
Agreement for the Holding of a
Special Meeting of Directors

We, the undersigned, being all the members of the Board of Directors of Gulf Coast Irrigation Company, a corporation organized under the laws of the State of Texas, do hereby agree that a meeting of the Directors may be held at the office of the corporation, Bay City, Texas, at any time during the day of November 18, A. D. 1931, for the purpose of considering and acting upon any and all matters of any sort which may be brought before the meeting incident to [fol. 106] the business and affairs of this corporation, including particularly, without limiting the generality of the foregoing agreement:

1. For the purpose of considering and acting upon the proposed dissolution of the corporation and the declaration of dividends in liquidation of the properties and assets of the corporation.
2. For the purpose of transacting any and all other business pertaining to the affairs of the corporation which may come before the meeting.

Dated November 18, A. D. 1931.

V. L. LeTulle, E. L. McDonald, Sam V. LeTulle,
 J. C. Lewis, Louis LeTulle.

There were present at said meeting the following Directors: To-wit: all of the Directors V. L. LeTulle; E. L. McDonald, Sam V. LeTulle, J. C. Lewis, Louis LeTulle being all of the members of the Board of Directors of the corporation.

Mr. V. L. LeTulle, President of the corporation, presided as chairman of the meeting, and Mr. E. L. McDonald, Secretary of the corporation, acted as Secretary of the meeting. The waiver of notice and the agreement for the holding of the meeting was examined, approved and ordered inserted in the Minute Book of the Company.

The chairman stated that since all of the members of the Board of Directors were present, the meeting was duly organized and ready for the transaction of business. Thereupon the Secretary presented and read to the meeting resolutions adopted at a special meeting of the stockholders of

the corporation held on November 7, 1931, and a certificate and consent signed by all of the stockholders evidencing the [fol. 107] desire and intention to dissolve the corporation and their consent thereto. The chairman stated in view of the contemplated dissolution of the corporation it was in order to declare a dividend in partial liquidation. Thereupon, on motion duly made, seconded and unanimously carried, it was

Resolved, that the Directors of this corporation do hereby declare, authorize and direct the payment of a dividend in partial liquidation of the shares of the capital stock of this corporation to be paid in property, by the transfer and delivery of the following described promissory notes:

Farmers Storage Company	\$30,250.83
R. F. Carpenter	60.51
T. J. Poole & Son	387.39
John T. Williams	1,459.03
C. A. Williams	1,264.20
	<hr/>
	\$33,421.96

and

Resolved Further, that the officers of this corporation be and they hereby are authorized and directed to transfer and deliver the promissory notes above described forthwith to and among the stockholders of this corporation, accordingly as their respective interests may appear.

The chairman stated that there would be further business to be transacted by the Board of Directors and that it was in order to adjourn the meeting to reconvene at a later hour in the day.

Thereupon, on motion duly made, seconded and unanimously carried, it was

Voted to adjourn the special meeting of the Directors until 4 o'clock P. M., on this 18 day of November, 1931, at which time said meeting shall be reconvened.

[fol. 108] The special meeting of the Board of Directors of Gulf Coast Irrigation Company was reconvened at the office of the Company, Bay City, Texas, on this 18 day of November, A. D. 1931 at 4 o'clock P. M.

The following Directors were present: To-wit, all of said Directors.

The chairman stated that during the interim between the time of the adjournment of this meeting and the time it had reconvened, the plan of reorganization of the interests of this corporation in its properties and assets and business had been consummated by the transfer and conveyance of all of the properties, assets and businesses of this corporation to Gulf Coast Water Company, in exchange for Fifty Thousand Dollars (\$50,000.00) in cash and Seven Hundred Fifty Thousand Dollars (\$750,000.00) in principal amount of the First Mortgage 6% Serial Gold Bonds of said corporation. He stated further that since all of the stockholders of this corporation have heretofore authorized the dissolution of the corporation and the surrender of its charter, both by resolution duly adopted by all of the stockholders and by written consent, it would be in order for the Directors to approve and authorize the transfer of the cash and Bonds received by this corporation as aforesaid, in liquidation of the stock.

Thereupon, on motion duly made, seconded, and unanimously carried, it was

Resolved, that the Board of Directors of this corporation do hereby declare and authorize the payment of a dividend in liquidation of the issued, and outstanding capital stock of this corporation, and hereby authorize and direct the distribution of the cash and Bonds received in consummation of the plan of reorganization of the interests of this corporation and the properties, assets and business formerly held [fol. 109] and owned by it, among the stockholders of this corporation, proportionately as their interests may appear, in full and final liquidation of the stock held by them, respectively; and

Resolved Further, that the proper officers of this corporation be and they hereby are authorized and directed to deliver and transfer such cash and Bonds in accordance with the directions and authority contained in these resolutions, upon surrender and delivery by each stockholder for cancellation of the certificate of stock in this corporation held by such stockholder for all shares of stock held; and

Resolved, Further, that upon receipt of such certificates of stock the same shall be cancelled; and

Resolved, Further, that the proper officers of this corporation be and they hereby are authorized and directed to make and file with the Secretary of State of the State of Texas such certificates and other instruments as may

be required or be necessary in order to effect dissolution of this corporation and surrender its charter.

The chairman stated that there was no further business to come before the meeting and thereupon, on motion duly made, seconded, and unanimously carried, it was

Voted, to adjourn.

V. L. LeTulle, Chairman.

A True Record: E. L. McDonald, Secretary."

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The plaintiff then and there introduced in evidence, a Deed from the Gulf Coast Irrigation Company to Gulf Coast Water Company, of dated November 18, 1931, and duly recorded in Deed Records, Matagorda County, Texas, at Volume 93 page 444 et seq.

[fol. 110]

Exhibit No. 27

"THE STATE OF TEXAS,
County of Matagorda.

Know All Men by These Presents:

That, Gulf Coast Irrigation Company, a corporation duly organized and existing under and by virtue of the laws of the State of Texas, with its domicile and principal place of business in Bay City, Matagorda County, Texas, hereinafter sometimes called "Grantor", for and in consideration of the sum of One Hundred Dollars (\$100.00), and other good and valuable considerations this day paid to it by Gulf Coast Water Company, a corporation duly organized and existing under and by virtue of the laws of the State of Texas, with its domicile and principal place of business in Bay City, Matagorda County, Texas, hereinafter sometimes called "Grantee", receipt whereof is hereby acknowledged, pursuant to authority granted by resolution of the stockholders and directors of Grantor, a copy thereof being hereto attached marked for identification "Exhibit A", have granted, bargained, sold, conveyed, assigned, transferred, set over and delivered, and by these presents do grant, bargain, sell, convey, assign, transfer, set over and deliver unto the said Grantee, all of the following described.

property lying and being situate in the Counties of Matagorda and Wharton, in the State of Texas, to-wit:

(Here was inserted a description of all the properties of the Gulf Coast Irrigation Company that were transferred to Gulf Coast Water Company, which properties were those set out as Exhibit A to the contract between those two companies November 4, 1931.)

"To Have and to Hold all of the above described premises or properties, together with all and singular the rights, liberties, privileges, hereditaments, and appurtenances be- [fol. 111] longing to or in anywise appertaining to any or all of the premises or properties herein described, or intended to be described, unto the said Gulf Coast Water Company, its successors and assigns, forever.

"And Grantor does hereby bind itself, its successors and assigns, to warranty and forever defend all and singular the said premises and properties herein described, or intended to be described, unto the said Grantee, its successors and assigns, against every person whomsoever lawfully claiming or to claim the same or any part thereof.

"In consideration of the sums paid to Grantor by Grantee, and other valuable considerations, receipt whereof is hereby acknowledged, V. L. LeTulle joins in the execution of this deed, for the purposes of warranting title to the properties hereby conveyed to Grantee and entering into and making the covenants and agreements hereinafter contained. The said V. L. LeTulle does hereby bind and obligate himself, his heirs, executors and administrators to warrant and forever defend all and singular the said premises and properties herein described, or intended to be described, unto the said Grantee, its successors and assigns, against every person whomsoever lawfully claiming or to claim the same or any part thereof, and it is expressly agreed by him that this warranty shall be of the same force and effect, and shall be binding upon him to the same extent, as though he had executed this deed in the capacity of a Grantor of the properties hereby conveyed.

"Grantor and V. L. LeTulle, respectively, covenant and agree that they will not, individually or collectively, engage, directly or indirectly, in the irrigation business in either Wharton or Matagorda Counties, Texas, for a period of thirty (30) years from the date hereof, unless they, or either of them, through repurchase or otherwise acquire

the ownership of the properties and premises hereby conveyed [fol. 112] to Grantee, in which event they, or the one so acquiring the said properties, shall be relieved from this covenant.

"V. L. LeTulle further covenants and agrees that he will not operate an irrigation plant or system for the purpose of supplying the lands now owned by him or which he may hereafter acquire with water or for the supplying of any of his tenants with water for a like period of thirty (30) years from the date hereof, provided, that should LeTulle acquire by purchase or otherwise the properties and premises hereby conveyed, he shall likewise be released from this covenant.

"In Witness Whereof, Gulf Coast Irrigation Company has caused this instrument to be signed in its name and behalf by its President, and its corporate seal duly attested by its Secretary to be affixed hereto, and V. L. LeTulle has signed the same, on this the 18 day of November, A. D. 1931.

Gulf Coast Irrigation Company, by V. L. LeTulle,
President. (Corporate seal.)

Attest: E. L. McDonald, Secretary. (Signed) V. L. LeTulle.

(The above deed duly acknowledged by V. L. LeTulle, President of Gulf Coast Irrigation Company as the act of said corporation and in the capacity therein stated.)

(It is also acknowledged by V. L. LeTulle, individually. Both acknowledged before Lola E. Williamson, Notary Public, Matagorda County, Texas, on November 19, 1931, under seal.)

[fol. 113] — "Certificate of Record

"THE STATE OF TEXAS,
County of Matagorda:

I, Ruby Hawkins, Clerk of the County Court in and for said County, do hereby certify that the foregoing instrument of writing with its certificate of authentication, was filed for record in my office the 24th day of Nov., 1931, at 4:35 o'clock P. —, and duly recorded the 4th day of Dec. 1931, at 9:05 o'clock A. M. the deed records of said County in Vol. 93 on page 444 et seq.

"Witness my hand and seal of County Court of said County, at office in Bay City, Texas, the day and year last above written.

Ruby Hawkins, Clerk County Court, Matagorda County, Texas, By — — —, Deputy. (Seal.)"

"No. 1412 Law. Filed: June 24, 1937. Maxey Hart, Clerk, by Joe Steiner, Dep."

EXHIBIT No. 28

The plaintiff then and there introduced in evidence Deed of Trust from Gulf Coast Water Company *Company* to J. C. Lewis, Trustee, dated November 18, 1931.

"THE STATE OF TEXAS,
County of Matagorda:

"This Indenture of Mortgage, made as of the 1st day of September, A. D. 1931, but actually executed the day and year lastly herein stated, by and between Gulf Coast Water Company, a corporation duly organized and existing under [fol. 114] and by virtue of the laws of the State of Texas and having its principal place of business in Bay City, Matagorda County in said State, hereinafter sometimes called the "Company", party of the first part; and J. C. Lewis of Bay City, Matagorda County, Texas, hereinafter sometimes called the "Trustee", party of the second part;

"Witnesseth:

"That, Whereas, the Company is duly authorized to own and operate water plants, properties and systems and has full power and authority to contract debts, to borrow money, to issue and dispose of its obligations, and to convey and pledge by way of mortgage or deed of trust, all of its property to secure the payment of such obligations and the interest thereon and the performance of its undertakings with respect thereto; and

"Whereas, the Company desires to issue and negotiate its First Mortgage 6% Serial Gold Bonds in the aggregate principal amount of Seven Hundred Fifty Thousand Dollars (\$750,000.00), all dated September 1st, 1931, and maturing as hereinafter in this Indenture provided, consisting of fifteen (15) Bonds of the denomination of Ten Thousand Dollars (\$10,000.00) each and twelve (12) Bonds of the denomination of Fifty Thousand Dollars (\$50,000.00) each,

all of said Bonds being numbered 1 to 27, inclusive, and all with appropriate coupons thereto attached; and

"Whereas, the Company is the owner of the property hereinafter described, and it desires to secure the payment of said Bonds and coupons by an Indenture of Mortgage on such property; and

"Whereas, the borrowing of said money, the execution and negotiation of said Bonds, and the execution and delivery of this Indenture of Mortgage (hereinafter some- [fol. 115] times referred to as "Indenture") has been fully, duly and legally authorized by the vote of the Board of Directors and stockholders of the Company at meetings duly called and held for that purpose; and

"Whereas, the Bonds to be issued under this Indenture and the coupons appertaining thereto and the Trustee's certificate are to be in respect of the subject matter of the several texts here following, substantially in the forms, subject to such changes, additions, omissions and variations as may be necessary to conform to any pertinent law or to usage, and may contain or bear such endorsements and/or legends as may be required, to-wit:

"(Form of Bond)

"United States of America

State of Texas

Gulf Coast Water Company

First Mortgage 6% Serial Gold Bond

No. —

\$ —

Gulf Coast Water Company (hereinafter called the "Company"), a corporation duly organized and existing under and by virtue of the laws of the State of Texas, for value received, acknowledges itself indebted and promises to pay to the order of Gulf Coast Irrigation Company, or any assignee hereof, or if this Bond be registered to the registered holder hereof, on the — day of — A. D. 19—, the sum of — in gold coin of the United States of America of or equal to the standard of weight and fineness existing on September 1, 1931, at the principal office of the First National Bank in the City of Bay City, County of Matagorda, State of Texas, and to pay interest thereon from September 1, 1931, at the rate of six percent (6%) per annum in like gold coin annually on the 1st day of January [fol. 116] in each year until the payment of the said prin-

cipal sum, but until maturity hereof only upon the presentation and surrender of the interest coupons hereto appertaining as they severally mature (the first coupon being for interest from September 1, 1931, to December 31, 1932) and with interest on past due principal and interest, if any, at the rate of six per cent (6%) per annum from the maturity thereof until paid.

"This bond is one of the duly authorized issue of Bonds of this Company limited to the aggregate principal amount of Seven Hundred Fifty Thousand Dollars (\$750,000.00) at any one time outstanding, known as its First Mortgage 6% Serial Gold Bonds, all issued under and equally and ratably secured by an Indenture of Mortgage (herein sometimes called "Indenture"), dated as of September 1, 1931, duly executed and delivered by the Company to J. C. Lewis of Bay City, Texas, as Trustee, to which Indenture reference is hereby made for a description of the property mortgaged and pledged, the nature and extent of the security, the rights of the holders of the Bonds in respect thereof, the rights and immunities of the Trustee. Said Bonds are issued in such series and mature at such times as provided in said Indenture.

"In case a completed default as defined in said Indenture shall occur, the principal of this Bond may become or be declared due and payable as provided in said Indenture.

"The Bonds issued pursuant to said Indenture are subject to redemption prior to maturity at the option of the Company in the following manner: If at any time prior to nine months from November 1, 1931, to-wit, on or before August 1, 1932, the Company shall elect in writing so to do it may redeem Bonds Numbers 16 to 27, both inclusive, by the payment of five-sixths of the principal amount of each of said Bonds, to-wit, the sum of Forty-one Thousand Six Hundred Sixty-six & 67/100 Dollars (\$41,666.67) plus [fol. 117] accrued interest to the date fixed for redemption at the rate and in the manner provided in said Indenture. After the expiration of said time—to-wit: On and after August 1, 1932, said Bonds Numbers 16 to 27, both inclusive, may be redeemed at any time upon at least thirty (30) days prior notice given by publication as provided in said Indenture at the principal amount thereof plus accrued interest to the date fixed for redemption. Bonds Numbers 1 to 15, both inclusive, may be redeemed at any time prior to January 1, 1933, without notice upon payment of the

principal amount thereof plus accrued interest to the date of redemption. If any Bond is called for redemption and payment duly provided as specified in said Indenture then and in that case such Bond shall cease to bear interest from and after the date fixed for redemption.

"This Bond is transferable upon endorsement and delivery by Gulf Coast Irrigation Company, or its assigns, unless registered as to principal in the name of the holders, at the office of the Trustee, such registry to be noted hereon by the Trustee. After such registration no transfer hereof shall be valid unless made at the office of the Trustee by the registered holder in person or by attorney, duly authorized in writing, and similarly noted hereon, but this Bond may be discharged from registration by being in like manner transferred to an assignee of such registered holder, and thereupon transferability by endorsement and delivery shall be restored, but again and from time to time this Bond may be registered or transferred to any assignee of such registered holder as before. Such registry, however, shall not affect the negotiability of the coupons for interest hereto annexed, which shall always continue to be payable to bearer and to be transferable by delivery merely, and payment to the bearer thereof shall fully discharge the [fol. 118] Company in respect of the interest therein mentioned, whether or not this Bond be registered as the principal.

"To the extent provided in said Indenture all rights of action on this Bond and the coupons annexed hereto are vested exclusively in the Trustee.

"Payment to the Trustee of the principal of or any interest on this Bond for the account of the holder hereof, shall, to the extent of such payment exonerate the Company from liability to the holder hereof.

"No recourse shall be had for the payment of the principal or the interest on this Bond or of any claim based hereon or in respect hereof or of said Indenture against any incorporator, stockholder, director, or officer of the Company, or of any successor corporation as such, either directly or through a Receiver or Trustee in Bankruptcy, whether by virtue of any statute or rule of law or by the endorsement of any assessment or penalty or otherwise, all liability being by the acceptance hereof expressly released.

"Neither this Bond nor any coupon hereto appertaining shall become valid or obligatory for any purpose until this

Bond shall have been authenticated by the execution of the certificate herein endorsed by J. C. Lewis, Trustee, under said Indenture, or his successor in trust.

"In Witness Whereof, Gulf Coast Water Company has caused this Bond to be signed in its name by its President or one of its Vice Presidents and its corporate seal to be hereunto affixed, and attested by its Secretary or one of its Assistant Secretaries, and coupons for said interest, bearing [fol. 119] the facsimile signature of its Treasurer to be attached hereto, and this Bond to be dated at Bay City, Matagorda County, Texas, as of September 1, 1931.

Gulf Coast Water Company, by ———, President.

Attest: ———, Secretary.

(Form of Interest Coupon)

"Coupon No. ——— \$——.

"On the — day of —, 19—, unless this Bond shall have been called for previous redemption, and payment thereof made or provided for, upon surrender of this coupon Gulf Coast Water Company will pay to bearer, at the principal office of J. C. Lewis, Bay City, Texas, in gold coin of the United States of America, being interest then due on its First Mortgage 6% Serial Gold Bond No. —.

———,
Treasurer.

(Form of Trustee's Certificate)

"This is to certify that this Bond is one of the Bonds referred to and described in the within mentioned Indenture.

———,
Trustee.

(Form of Registration Certificate)

Registration Certificate

"Notice to Holder: Do not write on this Bond. Consult Trustee for method of transfer and registration.

Date of
Registry:

In whose Name
Registered

Signature

[fol. 120]: And

Whereas, the Indenture or Mortgage and Deed of Trust authorized and adopted by the Directors of the Company to secure the payment of said Bonds and the interest to accrue thereon, is in the form of this Indenture as executed; and

Whereas, all acts, conditions and things necessary to make said Bonds, when duly executed by the Company and authenticated by the Trustee as in this Indenture provided, the valid legal and binding obligations of the Company, this Indenture a valid mortgage of and upon the real and personal property, rights, privileges and franchises herein described and/or intended to be subject to the lien and charge hereof to secure the payment of such Bonds, have happened and have been so done and performed, and the execution and delivery of this Indenture having been in all respects duly authorized;

"Now, Therefore, This Indenture of Mortgage Furthure Witnesseth:

"That, in order to secure the payment of the principal and interest on all Bonds issued under this Indenture according to their tenor and effect and the terms of this Indenture and the performance and observance of all the covenants and obligations herein contained, and to declare the terms and conditions on which the Bonds are to be issued, authenticated, secured, received and held and in consideration of the acceptance by the Trustee of the trusts hereby created and the purchase and acceptance of such Bonds by the holders thereof, and of One Dollar (\$1.00) lawful money of the United States of America in hand paid by the Trustee to the Company at or before the enrolling and delivery of this Indenture, the receipt whereof is hereby acknowledged, the Company has granted, bargained, sold, aliened, remised, released, conveyed, mortgaged, warranted, [fol. 121] confirmed, pledged, assigned, transferred and set over, and by this Indenture does grant, bargain, sell, alien, remise, release, convey, mortgage, warrant, confirm, pledge, assign, transfer, and set over unto the Trustee, and to his successor in trust hereby created, and to his assigns forever all and singular the properties, rights, privileges, franchises and interests of the Company, to-wit:

(Here was inserted a detailed description of all the properties that were transferred by Gulf Coast Irrigation Com-

pany to Gulf Coast Water Company by the Deed dated November 18, 1931.)

"To Have and to Hold the said properties, real, personal and mixed, hereby conveyed and assigned, or intended so to be, unto the Trustee and his successor in trust forever; and against all or every person or persons lawfully claiming or to claim the same or any part thereof, the Company, and its successors, will warrant and forever defend.

"In Trust, Nevertheless, for the equal and prorata benefit and security of each and every the persons, firms or corporations who may be or become holders of the Bonds and coupons issued hereunder, without preference, priority or distinction as to participation in the lien, benefit and protection hereof of one Bond or coupon over or from the others, by reason of the date or the dates of maturity thereof, or for any other reason whatsoever, so that each and all of such Bonds and coupons shall have the same right, lien and privilege under this Indenture and shall be equally secured hereby, with the same effect as if the same had all been made, issued and negotiated simultaneously with the delivery hereof, and under and subject to the covenants and conditions and for the uses and purposes and upon the terms hereinafter set forth; provided, nevertheless, and these presents are upon the express condition that unless and until [fol. 122] default hereunder shall have occurred and shall not have been waived, the Company shall be suffered and permitted to retain actual possession of the mortgaged property by it owned and subjected to the lien hereof, and to improve, operate and use the same and every part thereof, with the rights and franchises appertaining thereto, and to collect, receive, take, use and enjoy the tolls, earnings, income, rents, issues and profits thereof, and shall be suffered and permitted under the terms hereof to exercise any and every rights pertinent to said mortgaged property; provided further that if the Company shall well and truly pay or cause to be paid the principal of all Bonds at any time and from time to time issued hereunder, with interest, according to the true intent and meaning of such Bonds and each of them, and shall provide or cause provision to be made for the payment or redemption of such Bonds with interest when due by depositing or causing to be deposited with the Trustee the entire amount due thereon for principal and interest, and shall also pay or cause to be paid all

of the sums payable hereunder by the Company, then these presents and the estates and rights hereby granted shall cease, determine, and become void, and thereupon the Trustee, on payment of all lawful charges and disbursements then unpaid, on demand, and upon payment of the costs and expenses thereof, shall duly execute, acknowledge and deliver such instruments of satisfaction or other deeds or release or conveyance in respect of the mortgaged property as may be necessary or proper to discharge this Indenture of record, and shall duly execute, acknowledge to the Company such instruments of satisfaction or other deeds of release or conveyance in respect of the mortgaged property as may be necessary or proper to discharge this Indenture; otherwise this Indenture shall remain in full force.

[fol. 123] This Indenture Further Witnesseth: That the Company has agreed and covenanted and does hereby agree and covenant with the Trustee and with the respective holders from time to time of the Bonds and/or coupons issued hereunder and of each thereof, as follows, that is to say:

Article One

Definition of Terms

Section 1. In each and every place in and throughout this Indenture wherein the following terms or any of them are used, the same, unless the context shall indicate another or different meaning or intent, shall be construed, are used and are intended to have meanings and to be inclusive as follows:

(a) "The Company" and "Company"—Gulf Coast Water Company, party of the first part hereto, and its corporate successor or successors in title to the properties vested in it or in its successor and at the time of such succession subject to the lien thereof.

(b) "The Trustee" and "Trustee"—J. C. Lewis, party of the second part hereto and his successor or successors in the trusts hereby created and reposed in him.

(c) "Mortgaged Property", "Mortgaged Premises" and "Premises"—All of the property, real, personal and mixed at the time subject to the lien hereof.

(d) "President"—The President and each and every Vice President and each and every other officer of the cor-

poration concerned, authorized to exercise the powers and authority customarily reposed in the President of a corporation.

(e) "Secretary"—The Secretary and each and every assistant Secretary and each and every other officer of the corporation concerned authorized to exercise the power and authority customarily reposed in the Secretary of a corporation.

(f) "Treasurer"—The Treasurer and each and every Assistant Treasurer and each and every other officer of the corporation concerned authorized to exercise the powers and authority customarily reposed in the Treasurer of a corporation.

(g) "Counsel"—Any Counsel appointed by the Company.

(h) "Certified Copy of Resolution"—A copy of a resolution certified under seal by the Secretary of the corporation, the Board of Directors or stockholders whereof are represented to have passed such resolution, to have been passed by the requisite majority of such Board of Directors or stockholders duly passed and adopted at a meeting of such Board of Directors or stockholders duly called and convened.

Section 2. Words of any gender shall be deemed and construed to include correlative words of each other gender.

Section 3. The words "Bonds", "owner", "holder" and "person" shall include the plural as well as the singular number, unless the context shall otherwise indicate. The term "bondholders" means and contemplates, unless the context otherwise indicates, the holders of the Bonds at the time issued and outstanding hereunder. Each of the words "person", "corporation" and "association" shall include either or both of the others unless the context shall otherwise indicate.

[fol. 125]

Article Two

Issuance, Authentication, Negotiation and Registration of Bonds

Section 1. The Bonds issued under this Indenture shall from time to time be executed on behalf of the Company

by its President, under its corporate seal, attested by its Secretary, and shall be delivered to the Trustee for authentication by him. The coupons to be attached shall bear the facsimile signature of the present Treasurer of the Company which is hereby adopted for that purpose. In case any of the officers who shall have signed any Bonds or attested the seal thereon, or whose facsimile signature appears on the coupons shall cease to be such officer or officers of the Company before the Bonds so signed and sealed have been actually authenticated by the Trustee or delivered by the Company, such Bonds, nevertheless, may be issued, authenticated and delivered with the same force and effect as if the person or persons who signed such Bonds and attested the seal thereon (or whose facsimile signature appears on the coupons) had not ceased to be such officer or officers of the Company.

Section 2. The Bonds to be issued hereunder shall be known as the Company's First Mortgage 6% Serial Gold Bonds, and, except as provided in Section 5 of this Article shall be limited to the aggregate principal amount of Seven Hundred Fifty Thousand Dollars (\$750,000.00) at any one time outstanding. All of said Bonds issued hereunder shall be dated September 1, 1931, and shall be of the denominations, numbers and maturities as follows, to-wit:

[fol. 126] Number	Principal Amount of each Bond	Maturity Date
1	\$10,000.00	January 1, 1933
2	10,000.00	January 1, 1933
3	10,000.00	January 1, 1933
4	10,000.00	January 1, 1933
5	10,000.00	January 1, 1933
6	10,000.00	January 1, 1933
7	10,000.00	January 1, 1933
8	10,000.00	January 1, 1933
9	10,000.00	January 1, 1933
10	10,000.00	January 1, 1933
11	10,000.00	January 1, 1933
12	10,000.00	January 1, 1933
13	10,000.00	January 1, 1933
14	10,000.00	January 1, 1933
15	10,000.00	January 1, 1933
16	50,000.00	January 1, 1933
17	50,000.00	January 1, 1934

Number	Principal Amount of each Bond	Maturity Date
18	50,000.00	January 1, 1935
19	50,000.00	January 1, 1936
20	50,000.00	January 1, 1937
21	50,000.00	January 1, 1938
22	50,000.00	January 1, 1939
23	50,000.00	January 1, 1940
24	50,000.00	January 1, 1941
25	50,000.00	January 1, 1942
26	50,000.00	January 1, 1943
27	50,000.00	January 1, 1944

All of the Bonds shall bear interest at the rate, and shall contain the terms, conditions and provisions which are recited in the form of said Bonds and coupons hereinbefore fully set out. All annual interest coupons (including Coupon No. 1 for 16 months interest) shall be numbered to [fol. 127] correspond with the number of the Bonds to which they respectively belong.

Section 3. No Bond issued under this Indenture shall be or become obligatory unless or until it is authenticated by the signature of the Trustee to the certificate endorsed thereon, but when so authenticated, such certificate of the Trustee shall be the conclusive and only evidence that the Bond so certified was duly issued hereunder and is entitled to the benefit of the Trust hereby created.

Section 4. There shall be kept by the Company at the office of the Trustee a register for the registration and transfer of Bonds issued hereunder in which the Trustee, who is hereby appointed Registrar for that purpose, subject to reasonable regulations, and on payment to him by the bondholders, of such reasonable charge as he may prescribe, will register any Bond issued hereunder and secured hereby. Such registry shall be noted on the Bond by the Registrar and thereafter no transfer thereof shall be valid unless made on said register and similarly noted on the Bond, but the same may be discharged from registration by being in like manner transferred to an assignee of such registered holder and thereupon transferability by endorsement and delivery shall be restored; but the Bond may again from time to time be registered or transferred to any assignee of such registered holder as before. Such registry, however,

shall not affect the negotiability of any coupons annexed to the Bond, which shall always continue to be payable to bearer and to be transferable by delivery merely, and payment to the bearer thereof shall fully discharge the Company in respect of the interest therein mentioned, whether or not the Bond to which the same is annexed be registered as to principal.

The Company and the Trustee may deem and treat the assignee of any Bond outstanding hereunder, which shall [fol. 128] not at the time be registered in the name of the holder as hereinbefore authorized, and the bearer of any coupon for interest on any such Bond, whether such Bond shall be registered or not, as the absolute owner of such Bond or coupon, as the case may be, for the purpose of receiving payment thereof, or on account thereof, and for all other purposes, and neither the Company nor the Trustee shall be affected by any notice to the contrary. The Company and the Trustee may deem and treat the person in whose name any Bond outstanding hereunder shall be registered as hereinbefore provided, as the absolute owner thereof, for the purpose of receiving payment of or on account of the principal thereof, and for all other purposes, except to receive payment of interest represented by outstanding coupons, and all such payments so made to any such registered holder or upon its or his order shall be valid and effectual to satisfy and discharge the liability upon such Bond to the extent of the sum or sums so paid, and neither the Company nor the Trustee shall be affected by any notice to the contrary.

Section 5. In case any Bond issued hereunder with the coupons thereto belonging, shall, prior to the payment thereof, be mutilated, lost, stolen or destroyed, a new Bond, including coupons of like tenor and date and bearing the same distinctive numbers (if the same be known) may at the discretion of the Company and Trustee be executed, authenticated and delivered in exchange for and upon cancellation of the mutilated Bond and coupons, or in substitution for the Bond and coupons so lost, stolen or destroyed, upon receipt by them of:

(a) Evidence satisfactory to the Company and the Trustee of the loss, theft, or destruction of such Bond and its coupons; and

[fol. 129] (b) Proof of ownership thereof; and

(c) Such indemnity to the Company and the Trustee as shall be satisfactory to them; and

(d) Payment of cost of preparing such substituted Bond and coupons.

The Trustee shall incur no liability for anything done by it under this Section.

Section 6. No coupon belonging to any Bond issued hereunder which, in any way at or after maturity, shall have been transferred or pledged separate and apart from the Bond to which it relates, shall, unless accompanied by such Bond, be entitled in case of default hereunder to payment or to any benefit of or from this Indenture until after the prior payment in full of the principal of the Bonds issued hereunder and all coupons not so transferred or pledged. The Company shall not extend or consent to the extension of the time of the payment of any of the coupons belonging to any Bond issued hereunder, and if such extension be made with or without the consent of the Company, such coupons shall be subject to prior payment in full of all the Bonds and coupons, the payment of, which shall not have been so extended.

Section 7. The Company and every holder, purchaser, pledgee or transferee now or hereafter, of every Bond issued hereunder, shall be forever estopped to deny that the Bonds issued hereunder, save when registered as to principal, are negotiable instruments and have all the characteristics, not only of transferability but of complete negotiability, which pertain to negotiable instruments conforming to the requirements of the law merchants and of all applicable negotiable instrument laws.

Section 8. The entire principal amount of the Bonds authorized to be issued hereunder, to-wit. Seven Hundred [fol. 130] Fifty Thousand Dollars (\$750,000.00), shall be forthwith executed by the Company and authenticated by the Trustee, and thereupon the Trustee shall deliver the same to or upon the order of the President or one of the Vice Presidents of the Company.

Article Three

Redemption of Bonds

Section 1. Bonds numbered 1 to 15, both inclusive, may be redeemed at any time prior to January 1, 1933 without

notice upon payment of the principal amount thereof plus accrued interest to the date of redemption.

Section 2. Upon thirty days published notice as herein after provided (except as may be otherwise provided in this Article) the Company may, at its election, pay and redeem all or any of the Bonds at any time by payment of the principal amount thereof and accrued interest, to the date of redemption.

Section 3. The Company may if it shall elect so to do pay and redeem Bonds numbered 16 to 27, both inclusive, on or before August 1, 1932, by delivery of an instrument in writing to the Trustee evidencing its election to so pay and redeem the same, and specifying that date upon which the same are to be paid and redeemed, which shall not be prior to the date of the delivery of such instrument or subsequent to August 1, 1932, and by simultaneously delivering to the Trustee, or to the First National Bank of Bay City, Texas, to the order of the Trustee, Five Hundred Thousand Dollars (\$500,000.00) in cash, plus accrued interest on said sum from September 1, 1931, to the date of such redemption, which sum shall, for the purpose of this Section 3, be the redemption price of said Bonds (the redemption price of each Bond being Forty One Thousand Six Hundred [fol. 131] Sixty Six & 67/100 Dollars (\$41,666.67) plus interest as aforesaid). In the event of redemption and payment under this Section 3, all Bonds numbered 16 to 27, both inclusive, must be redeemed and paid at the price aforesaid, and such right may be exercised by the Company only in the event that it shall have paid and discharged all of the principal and interest due on Bonds numbered 1 to 15, both inclusive. Upon redemption of said Bonds under this Section 3, the Trustee shall publish notice thereof in the manner hereinafter in this Article provided and shall, upon presentation of said Bonds with all coupons thereto attached, pay the amount due and payable thereon at the redemption price hereinafter specified. Said Bonds shall not bear interest after the date fixed for the redemption thereof.

Section 4. In case the Company shall after August 1, 1932, have elected to pay off and redeem less than all of its Bonds issued hereunder, or in the event the Company shall desire to pay off and redeem a part only of the Bonds numbered

16 to 27, both inclusive, prior to August 1, 1932, it shall in writing notify the Trustee of its said election specifying the principal amount of the bonds which it desires to redeem and the date upon which it desires to make such redemption which shall not be less than Thirty (30) days after notification by the Company as aforesaid and the Company shall determine by lot in any usual manner the distinctive numbers of the Bonds so to be redeemed and shall certify same to the Trustee at the time of the delivery of the notice of redemption.

Before the date designated for the redemption of any Bonds in any such published notice, the Company shall deposit with the Trustee a sum of money sufficient to redeem, at such redemption price, the Bonds so called for redemption and to pay the interest due thereupon up to such redemption day, to be held for the account of the holders [fol. 132] thereof and to be paid to them respectively upon presentation and surrender of the Bonds so specified for redemption with all unpaid coupons annexed thereto.

Section 5. In case the Company shall elect to exercise such right to pay off and redeem all or any of the Bonds in accordance with the right reserved so to do, it shall (except, however, upon its election to redeem the same as provided in Section 3 above, in which event only the notice therein specified shall be given) give notice thereof by publication at least once in each week for three (3) consecutive weeks next prior to the date on which said payment and redemption is to be made, in each instance, upon any day of the week, the first publication to be not less than twenty-five (25) days prior to the date on which such redemption and payment is to be made, in daily newspapers of general circulation published in the English language in the County of Matagorda, Texas, which notices shall specify the date designated for such redemption and if the Company has elected to redeem less than all of the Bonds, the distinctive numbers of the Bonds so to be redeemed, and shall state that the interest on the Bonds in such notice designated for redemption will cease on the redemption date specified in such notice, and direct that such Bonds, together with all coupons annexed thereto, maturing on or after the date fixed for redemption be presented on said date for payment and redemption at the principal office of the Trustee in the City of Bay City, Texas. A similar no-

tice by registered mail, return receipt requested, shall be mailed by the Company, postage prepaid, at least twenty (20) days prior to the date designated for such redemption to all registered holders of the Bonds called for redemption, at the last address of such holders as the same shall then appear upon the Bond register, provided, however, that such mailing of notices shall not be prerequisite to redemption [fol. 183] and failure to mail such notices shall not invalidate any proceedings for redemption of Bonds if notice shall have been published in accordance with this Section.

Section 6. Notice of redemption having been given as provided in Section 5 of this Article Three, and a sum of money sufficient to redeem the Bonds so called for redemption having been deposited with the Trustee as provided in Sections 3 and 4 of this Article Three, the Bonds so called for redemption shall on the date designated for redemption in such notice become payable at the redemption price as aforesaid, and from and after the date of such redemption so stated, interest on the Bonds so called for redemption shall cease to accrue, and upon presentation and surrender at the principal office of the Trustee, in the City of Bay City, Texas, of any of the Bonds specified in said notice in accordance with such notice, together with all coupons thereunto appertaining maturing on and after such date of redemption, said Bonds shall be paid by the Trustee at the redemption price aforesaid. All unpaid interest coupons which shall have matured prior to such redemption date shall continue to be payable to the respective holders thereof but without interest thereon.

Section 7. On the deposit with the Trustee of an amount sufficient to pay and redeem all of the Bonds then outstanding under this Indenture at said redemption price and on delivery to the Trustee of (1) proof satisfactory to the Trustee that notice or notices of redemption has or have been given as provided in this Indenture in respect of the Bonds outstanding hereunder, or (2) proof satisfactory to the Trustee that arrangements have been made insuring to the satisfaction of the Trustee that such notice or notices will be given, or (3) a written instrument executed by the Company under its corporate seal expressed to be irrevocable, authorizing the Trustee to give such notice or notices [fol. 134] for and on behalf of the Company and on payment to the Trustee of all costs, charges and expenses

in relation thereto, or otherwise incurred hereunder, the Trustee shall, upon the written request of the Company, cancel and satisfy this Indenture and shall, at the expense of the Company, release, convey and transfer or cause to be released, conveyed and transferred to the Company, all of the Trust Estate and mortgaged property then held by the Trustee hereunder.

Section 8. The Trustee shall apply the monies deposited with it under any of the provisions of this Article to the payment, at the redemption price, of the Bonds so called for redemption, but in no event shall the Trustee be liable beyond the sum so deposited with him. Any such monies remaining unclaimed by the holders of the Bonds and Coupons for more than four years after deposit with the Trustee shall be paid by the Trustee to the Company; provided, however, that the Trustee before being required to make any such payments may, at the expense of the Company, cause to be published once a week for four (4) consecutive weeks in such newspapers of general circulation published in Matagorda County, Texas, not exceeding two, as the Trustee may determine, a notice that said monies remain unclaimed and that after a date named therein, unless claimed by those entitled thereto, they will be returned to the Company.

Section 9. All Bonds and Coupons appertaining thereto which shall be paid or redeemed pursuant to the provisions of this Article Three shall forthwith be cancelled and cremated by the Trustee, and certificates of such cremation shall be delivered to the Company on its written request and no Bond shall thereafter be issued in lieu of the Bond so redeemed, cancelled and cremated.

[fol. 135] Section 10. Nothing herein contained shall be construed to require the Trustee to inquire as to the right of the Company hereunder to redeem or retire any Bonds which the Company may at any time elect to redeem and retire pursuant to the provisions of this Article.

Article Four

Particular Covenants of the Company

The Company hereby covenants as follows:

Section 1. That it is lawfully and peaceably possessed and well seized in fee of all of the aforesaid mortgaged and

pledged property, has a good, sure, perfect, absolute and indefeasible estate; that it will maintain and preserve the lien of this Indenture as a first, prior and superior lien on all of the property mortgaged or pledged hereby, or intended so to be, so long as any of the Bonds issued hereunder are outstanding; and that it has a good, right, and lawful authority to mortgage and pledge the said mortgaged and pledged property, as provided in and by this Indenture and that it has done so hereby.

Section 2. That the mortgaged property hereby conveyed and transferred is free and clear of all general and special taxes or assessments, mechanics or other liens and encumbrances of any kind, name or character whatsoever prior or superior to the lien hereof, of which would or might become equal or superior hereto, save only taxes not yet past due.

Section 3. That it will duly and punctually pay the principal of and interest on all of the Bonds outstanding hereunder, according to the terms hereof and thereof and the coupons thereto appertaining.

Section 4. That it will pay all taxes and assessments lawfully levied or assessed upon the mortgaged and pledged [fol. 136] property, or upon any part thereof, or upon any income therefrom, or upon the interest of the Trustee in the mortgaged and pledged property when the same shall become due, and will duly observe and conform to all valid requirements of any governmental authority relative to any of the mortgaged and pledged property, and all covenants, terms and conditions upon or under which any of the mortgaged and pledged property, is held; that it will not suffer any lien to be hereafter created upon the mortgaged and pledged property, or any part thereof, or the income therefrom, prior to or on a parity with the lien of these presents, and within three months after the accruing of any lawful claims or demands for labor, materials, supplies or other objects, which if unpaid might by law be given preference or priority over or parity with this Indenture as a lien or charge upon the mortgaged or pledged property, or any part thereof, or the income thereof, it will pay or cause to be discharged or make adequate provision to satisfy or discharge the same, provided, however, that nothing in this Section contained shall require the Company to observe or

conform to any requirement of governmental authority, or to require or cause to be paid or discharged, or make provision for, any such lien or charge, or to pay any such tax or assessment so long as the validity thereof shall be contested in good faith and by appropriate legal proceedings unless such contest would result in loss of the Company's license to carry on its business and provided that such security for the payment of such lien, charge or tax shall be given as the Trustee may require and that, save as aforesaid, it will not suffer any matter or thing whereby the lien hereof might or could be impaired.

Section 5. That it will at all times maintain, preserve and keep the mortgaged property in good repair, working order and condition, and at all times keep and maintain in [fol. 137] good order, condition and repair all and every part of the buildings, improvements, furniture, furnishings, fixtures, machinery and equipment, and all canals, ditches, flumes, culverts, bridges, embankments, meters, and other improvements and property owned, held or used in connection with its canal system, now or hereafter at any time erected or placed upon or in said premises during the continuance of the lien hereof, and will maintain and operate, or cause to be maintained and operated, the plants and properties for the purpose of supply water to the public for irrigation or other uses and will continue its business as a going concern; that it will from time to time make all needful and proper repairs, replacements, renewals and betterments, so that at all times the value of the security for the Bonds issued hereunder and the efficiency of the said property and equipment, and the value of the property of the Company shall be fully preserved and maintained; that it will at all times maintain its corporate existence and right to carry on the business or businesses in which it is engaged, and duly procure all renewals and extensions thereof, and will diligently maintain, preserve and renew all the rights, powers, privileges, licenses and franchises owned by it.

Section 6. That it will execute and deliver such further instruments and do such further acts as may be necessary or proper to carry out more efficiently the purposes of this Indenture, to transfer to any new Trustee, or Trustees, the estate, powers, instruments, or funds held in Trust hereunder.

Section 7. That in event of a completed default, it will pay to the Trustee all expenses incurred by him in the execution of the Trust hereof, including a reasonable compensation for his services and the compensation of his counsel; and all other sums of money paid or advances made by [fol. 138] the Trustee on account of any taxes, charges, assessments, liens, insurance or protection premiums, or otherwise; and in case of default in the payment thereof on the part of the Company, with interest at the rate of six percent (6%) per annum from the date or dates of said respective payments, the Trustee shall have a lien therefor on the Trust Estate as hereinbelow provided, but the Company shall not be required to pay any compensation to the Trustee or his counsel until a completed default occurs.

Section 8. That it will not at any time insist upon or plead, or in any manner whatsoever claim, or take the benefit or advantage of, any stay or extension law, now, or at any time hereafter in force provided for the valuation or appraisement of the mortgaged or pledged property, or any part thereof, prior to any sale or sales thereof, to be made pursuant to any provisions herein contained, or to the decree of any court of competent jurisdiction; nor after any such sale or sales will it claim or exercise any right under any statute enacted by the United States of America, or the State of Texas, or any other State, to redeem the property so sold, or any part thereof, and the Company hereby expressly waives all benefits and advantages of any such law, or laws; and it covenants that it will not hinder, delay or impede the execution of any power herein granted or delegated to the Trustee, but it will suffer and permit the execution of every such power, as though no such law had been made or enacted.

Section 9. That it will not go into voluntary bankruptcy or insolvency, or apply for or consent to the *to the* appointment of a Receiver of itself or of its properties, or make any general assignment for the benefit of its creditors, or suffer or permit any order for the appointment of a Receiver of itself or of its properties, or adjudicating it a [fol. 139] bankrupt or insolvent, to be made and remain unvacated for a period of sixty (60) days.

Section 10. That it will not consolidate with or merge into or suffer or permit itself to be consolidated with or

merged into, any other corporation, or sell, convey or transfer the mortgaged and pledged property as an entirety, or substantially as an entirety, except subject to the limitations and conditions in Article Twelve of this Indenture.

Section 11. That it will at all times keep all buildings and improvements at any time forming a part of the mortgaged property, and the equipment, furniture, furnishings, fixtures, fittings, elevators, machinery, appliances and other appurtenances therein contained, insured in an Insurance Company or companies having a permit to do business and which are doing business within the State of Texas against loss or damage by fire and other risks, if any, against which companies engaged in a similar business and operating under similar conditions usually insure, and in such amounts as are usually carried by companies engaged in a similar business and operating under similar conditions, but in no event for a greater sum or sums than the amount of insurance carried by the Gulf Coast Irrigation Company and/or V. L. LeTulle at the time of transfer of said property to the Company, with loss payable to the Trustee as his interests may appear, and the policy or policies and a statement of the premiums then due or to become due thereon shall be deposited with the Trustee. The Trustee, however, shall not be under any duty to demand either possession of the policies or such detailed statements, but may in his discretion, demand the same, and upon such demand, the Company shall deliver the policies or a statement as demanded by the Trustee. Should the Company fail to effect or continue such insurance, or should the insurance effected by it at any time be deemed by the Trustee to be inadequate [fol. 140] for the complete protection of the holders of the Bonds issued hereunder, the Trustee may insure said premises, and may, if deemed by him necessary, effect additional insurance; but the Trustee shall not be required to insure said premises or to effect additional insurance; as aforesaid, unless he is required in writing by the holders of twenty-five (25%) in amount of the Bonds then outstanding and is tendered indemnity satisfactory to him against all costs and expenses which he may incur by acting in pursuance of such request.

Section 12. All insurance monies payable in respect of the destruction of or damage to any building, improvements, or property, mortgaged hereunder, shall be collected by the

Trustee, and, if the same be less than Twenty-five Hundred Dollars (\$2500.00) shall, when, as and if received by the Trustee, be immediately paid over to the Company upon its written request, signed by its President, or one of its Vice Presidents. If, however, such insurance monies exceed Twenty-five Hundred Dollars (\$2500.00) the same shall, at the request and election of the Company, to be exercised by its Board of Directors

(a) Be paid over to the Company for the purpose of replacing or repairing the destroyed or damaged buildings, improvements or property (to the extent that insurance monies arising from such loss are in the hands of the Trustee), upon receipt by the Trustee of a certificate of the Treasurer of the Company showing the expenditures made for such purposes, but not to exceed the cost or fair value (whichever is lower) to the Company of such replacement or repairs. If any such property shall be fully replaced or repaired, and the expenses thereof shall be fully paid, the Trustee, upon receipt of a certificate of the Treasurer of the Company to that effect; shall apply the balance of any such insurance monies remaining in his hands applicable [fol. 141] to such replacement or repairs as provided in (b) of this Section 12.

(b) Be held by the Trustee and applied, to the extent that the same is sufficient to pay and discharge the same, to the payment of the interest and principal of the Bonds issued hereunder when the same shall become due and payable; provided that no insurance monies shall be used as provided in this subdivision (b) unless there shall be delivered to the Trustee a certificate signed and verified by the President or one of the Vice Presidents of the Company, or by an engineer or other expert (who may be in the employ of the Company) approved by the Trustee, stating the buildings, improvements or property whose destruction or damage has resulted in the payment of such insurance monies, and stating (1) that the replacements or repair of the same is unnecessary for the purpose of the Company's activities; and (2) that in their opinion such use of such insurance monies instead of the use thereof provided in subdivision (a) of this Section 12 will not be disadvantageous to the holders of the Bonds issued or to be issued hereunder.

Section 13. The Company covenants and agrees that it

mencing December 31, 1932, while any of the Bonds issued hereunder are outstanding, and until all thereof and the coupons thereto attached are paid in full, deposit with the Trustee, at his principal office in the City of Bay City, Texas, or at the principal office of any successor Trustee, or at the First National Bank of Bay City, Texas, to the order of the Trustee a sum of money equal to the entire amount due and payable upon the principal of any and all Bonds due and payable and by their terms maturing upon January 1st of the next succeeding year, and a sum of money equal to the entire amount due and payable upon the coupons maturing [fol. 142] and becoming due and payable upon January 1st of the next succeeding year, such sums so deposited to be applied by the Trustee to the payment of the Bonds and coupons so maturing and becoming due and payable upon presentment and surrender thereof. As to the payments and deposits so made by the Company, and to the extent thereof, the Company shall have satisfied and discharged its liability with respect to the Bonds and coupons so maturing and becoming due and payable, and the holders thereof shall look solely to the funds held by the Trustee or deposited in said Bank for payment. In no event, however, shall the Trustee or said Bank be liable or accountable to any holder for interest upon any funds so deposited or paid, but shall be required to pay out of such funds to such holder, upon presentation and surrender of the Bonds and coupons for the payment of which such deposit was made, only the amount actually due and payable thereon according to their terms, and no more.

Section 14. The enumeration in this Article of specific covenants or obligations of the Company is not intended to exclude or restrict the covenants or obligations assumed by the Company as otherwise provided for in this Indenture.

Article Five

Possession and Use of Mortgaged Property

Section 1. While not in default in the payment of principal or interest on any Bond then outstanding hereunder, or in respect of any of the covenants, agreements or conditions in this Indenture contained, the Company shall be suffered and permitted to possess, use and enjoy the mortgaged and pledged property, and to receive and use the

rents, issues, income, product and profits thereof, with power, in the ordinary course of business, freely and without let or hindrance on the part of the Trustee or of the [fol. 143] bondholders, and, except as herein otherwise expressly provided to the contrary, to exercise any and all rights under choses in action and contract.

Section 2. Unless and until there shall have been a completed default and the Trustee shall have entered upon and taken possession of the mortgaged property (and so long as such possession continued) the Company shall have power in the ordinary course of business, freely and without let or hindrance on the part of the Trustee or of the bondholders, to use, sell and otherwise dispose of and deal with all crops and products or other personal property held, owned or received by it, whether grown on its land, or received in payment of or as security for any water rentals or other charges of the Company.

Section 3. Should any of the mortgaged property be taken by exercise of the power of eminent domain, or should any governmental body or agency, at any time exercise any right which it may have to purchase any part of the mortgaged property, the Trustee may release the property so taken or purchased, and shall be fully protected in doing so upon being furnished an opinion of counsel to the effect that such property has been taken, by the exercise of the power of eminent domain, or purchased by a governmental body or agency in the exercise of a right which it had to purchase the same. The proceeds of all property so taken or purchased shall be paid over to the Trustee, and if paid over to the Trustee hereunder, shall be used in the same manner as the proceeds of sales of part of the mortgaged property, as provided in Article Six of this Indenture.

[fol. 144]

Article Six

Remedies of Trustees and Bondholders Upon Default

Section 1. Upon the occurrence of any one or more of the following events (hereinafter sometimes called "completed default"), namely:

(a) Default in the payment of the principal of any Bond hereby secured when the same shall become due and payable, whether at maturity as therein expressed, or by declaration, or otherwise:

(d) Default continued for sixty (60) days in the payment of any interest upon any Bond hereby secured; or

(c) Default in the covenants of the Company with respect to bankruptcy, insolvency, receivership or general assignment contained in Section 9 of Article Four hereof; or

(d) Default continued for sixty (60) days after notice to the Company from the Trustee in the performance of any other covenant, agreement or condition herein contained; the Trustee may, and, upon written request of the holders of forty-five percent (45%) in principal amount *amount* of the Bonds then outstanding hereunder shall, by notice in writing delivered to any office of the Company, declare the principal of all Bonds hereby secured then outstanding and the interest accrued thereon immediately due and payable, and such principal and interest shall thereupon become and be immediately due and payable; subject, however, to the right of the holders of fifty-five percent (55%) in principal *amount* of said Bonds, by written notice to the Company and to the Trustee, to annul such declaration and destroy its effect at any time before any sale hereunder, if before any such sale all agreements, with respect to which default shall have been made, shall be fully performed, and all arrears of interest upon all Bonds, outstanding hereunder, and the reasonable expenses and charges of the Trustee, his agents and attorneys and all other indebtedness secured hereby, except the principal of any Bonds not then due by their terms, and interest accrued on such Bonds since the last interest date, shall be paid, or the amount thereof shall be paid to the Trustee for the benefit of those entitled thereto.

Section 2. Upon the occurrence of one or more completed defaults the Company, upon demand of the Trustee, shall forthwith surrender to the Trustee the actual possession of, and it shall be lawful for the Trustee, by such officer or agent as he may appoint, to take possession of, all the mortgaged property, with the book, papers and accounts of the Company, and to hold, operate and manage the same, and from time to time make all needful repairs, and such alterations; replacements, additions, betterments, and improvements as to the Trustee shall seem wise; and to receive the rents, income, issues and profits thereof, and out of the same to pay all proper costs and expenses of so taking, holding

and managing the same, including reasonable compensation to the Trustee, his agents and counsel, incurred after said default, and any charges of the Trustee hereunder, any taxes and assessments and other charges prior to the lien of this Indenture which the Trustee may deem it wise to pay, and all expenses of such repairs, alterations, replacements, additions, betterments, and improvements, and to apply the remainder of the monies so received by the Trustee, first to the payment of installments of interest which are due and unpaid, in the order of their maturity, and next, if the principal of said Bonds is due, to the payment of the principal pro rata without any preference or priority whatever, except as provided in Article Two, Section 6 hereof. Whenever all that is due upon such Bonds and installments of interest [fol. 146] and under any of the terms of this Indenture shall have been paid and all defaults made good, the Trustee shall surrender possession to the Company, its successors or assigns, the same right of entry, however, to exist upon any subsequent default.

Section 3. Upon the occurrence of one or more completed defaults it shall be lawful for the Trustee by such officer or agent as he may appoint, with or without entry to sell all the mortgaged and pledged property as an entirety, or in such parcels as the holders of a majority in principal amount of the Bonds then outstanding hereunder shall in writing request, or in the absence of such request, as the Trustee may determine, at public auction, at the courthouse door of Matagorda County, Texas, in the City of Bay City, Matagorda County, Texas, on the first Tuesday of any month between the hours of ten o'clock A. M. and four o'clock P. M., or such other place as may be required by law, having first given notice of such sale by publication in at least one daily newspaper of general circulation, published in the County of Matagorda, Texas, at least once a week for four (4) weeks next preceding such sale, and any other notice which may be required by law, and from time to time to adjourn such sale in his discretion by announcement at the time and place fixed for such sale, without further notice; and, upon such sale to make and deliver to the purchaser or purchasers a good and sufficient deed or deeds for the same, which shall be a perpetual bar, both at law and in equity, against the Company, and all persons and corporations lawfully claiming or to claim by, through or under it.

And it is stipulated and agreed that in case of any sale hereunder all prerequisites to said sale shall be presumed to have been performed, and that in the conveyance and/or assignment given hereunder to any purchaser, all statements of fact or recitals therein made shall be full proof [fol. 147] and evidence of the matters therein stated and no other proof shall be requisite of the non-payment of money secured or of any default of the Company or as to the request to the Trustee to enforce this trust or the advertisement of sale or the time, place, and manner of sale, or of any particulars thereof or as to any other preliminary act or thing, or of the inability, refusal or failure of the Trustee, or any substitute Trustee, to act or the resignation of any Trustee, as herein provided, either as to the regularity of its appointment or otherwise, or of the contingencies which brought about the failure or inability of the Trustee to act, or of the request of the Trustee to do or perform any act hereunder, and all prerequisites of any such sale shall be presumed to have been performed (whether the sale be made by the Trustee or any successor Trustee).

Section 4. In case of the breach of any of the covenants or conditions of this Indenture, the Trustee shall have the right and power to take appropriate judicial proceedings for the enforcement of his right and the right of the bondholders hereunder. In case of a completed default hereunder, the Trustee may, either after entry, or without entry, proceed by suit or suits at law or in equity to enforce payment of the Bonds then outstanding hereunder and to enforce this mortgage and to sell the mortgaged and pledged property under the judgment or decree of a court of competent jurisdiction; and it shall be obligatory upon the Trustee to take action, either by such proceedings, or by the exercise of his powers with respect to entry or sale, as it may determine, upon being requested so to do by the holders of forty-five (45%) in principal amount of the Bonds then outstanding hereunder, and upon being indemnified as hereinafter provided.

No remedy by the terms of this Indenture conferred upon or reserved to the Trustee (or to the bondholders) is intended to be exclusive of any other remedy, but each and every remedy shall be cumulative and shall be in addition to any other remedy given hereunder or now or hereafter existing at law, or in equity or by statute.

No delay or omission to exercise any right or power accruing under any default, shall impair any such right or power or shall be construed to be a waiver of any such default or acquiescence therein; and every such right and power may be exercised from time to time and as often as may be deemed expedient.

Section 5. Anything in this Indenture to the contrary notwithstanding, the holders of a majority in principal amount of the Bonds then outstanding hereunder shall have the right at any time by an instrument in writing executed and delivered to the Trustee, to direct the method and place of conducting all proceedings to be taken for any sale of the mortgaged and pledged property, or for the foreclosure of this Indenture, or for the appointment of a Receiver; provided, that such direction shall not be otherwise than in accordance with the provisions of law or of this Indenture.

Section 6. In case of a completed default hereunder, and, upon the filing of a bill in equity or other commencement of judicial proceedings to enforce the right of the Trustee and of the bondholders under this Indenture, the Trustee shall be entitled as a matter of right, to the appointment of a Receiver, or Receivers of the mortgaged and pledged property, and of the income, rents, issues and profits thereof, pending such proceedings, with such powers as the court making such appointment shall confer.

Section 7. Upon any sale being made either under the power of sale hereby given or under judgment or decree in any judicial proceeding for the foreclosure or otherwise for the enforcement of this Indenture, the principal of all Bonds [fol. 149] then outstanding hereunder, if not previously due, shall at once become and be immediately due and payable.

Section 8. Upon any sale made either under the power of sale hereby given, or under judgment or decree in any judicial proceedings for a foreclosure or otherwise for the enforcement of this Indenture, any bondholder or bondholders, or the Trustee, may bid for and purchase the mortgaged and pledged property, and upon compliance with the terms of sale, may hold, retain and possess and dispose of such property in their or his own absolute right without further accountability and any purchaser at any such sale may, in paying purchase money, turn in any of

the Bonds and coupons outstanding hereunder in lieu of cash to the amount which shall, upon distribution of the net proceeds of such sale, be payable thereon, subject, however, to the provisions of Article Two, Section 6 hereof; provided, however, that in all cases the purchaser or purchasers shall pay in cash a sufficient sum to cover the items referred to in paragraph First of Section 11 of this Article Six. Said Bonds and coupons, in case the amount so payable thereon shall be less than the amount due thereon, shall be returned to the holders thereof after being properly stamped to show partial payment.

Section 9. Upon any sale made either under the power of sale hereby given, or under judgment or decree in any judicial proceedings for the foreclosing or otherwise for the enforcement of this Indenture, the receipt of the Trustee or of the officer making such sale shall be a sufficient discharge to the purchaser or purchasers at any sale for his or their purchase money, and such purchaser or purchasers, his or their assigns or personal representatives, shall not, after paying such purchase money and receiving such receipt of the Trustee or of such officer therefor, be obliged to see to the application of such purchase money, or be in anywise [fol. 150] answerable for any loss, misapplication or non-application thereof.

Section 10. Any sale made either under the power of sale hereby given or under judgment or decree in any judicial proceedings for foreclosure or otherwise for the enforcement of this Indenture, shall operate to divest all right, title, interest, claim and demand whatsoever, either at law or in equity of the Company of, in and to the property so sold, and shall be a perpetual bar both at law and in equity against the Company, its successors and assigns and against any and all persons claiming or who may claim the property sold, or any part thereof, from through or under the Company, its successors or assigns.

Section 11. The proceeds of any sale made either under the power of sale hereby given, or under judgment or decree in any judicial proceeding for the foreclosure or otherwise for the enforcement of this Indenture, together with any other amounts of cash which may then be held by the Trustee, as part of the mortgaged and pledged property, shall be applied as follows:

First. To the payment of all taxes, assessments, or liens prior to the lien of this Indenture, except those subject to which such sale shall have been made, and all the costs and expenses of such sale, including reasonable expenses of such sale, and reasonable compensation to the Trustee, his agents and attorneys, for all services or charges arising after completed default, and of all other sums payable to the Trustee hereunder by reason of any expenses or liabilities incurred or advances made (or caused by him to be made) in connection with the management or administration of the Trust hereby created.

Second. To the payment in full of the amount then due and unpaid of principal and interest upon the Bonds then [fol. 151] outstanding hereunder; and, in case such proceeds shall be insufficient to pay in full the amount so due and unpaid, then to the payment thereof ratably, with interest on the overdue principal at the rate expressed in the Bonds, without preference or priority of principal over interest, or of interest over principal, or of any installments of interest over any other installments of interest subject, however, to the provisions of Article Two, Section 6 hereof.

Third. Any surplus thereof remaining to the Company, its successors or assigns, or to whomsoever may be lawfully entitled to receive the same.

Section 12. In case of a default on its part, as aforesaid, neither the Company, nor anyone claiming through or under it, shall or will set up, claim or seek to take advantage of any appraisement, valuation, stay, extension or redemption laws now or hereafter in force in any locality where any of the mortgaged and pledged property may be situated, in order to prevent or hinder the enforcement or foreclosure of this Indenture, or the absolute sale of the mortgaged and pledged property hereby conveyed, or the final and absolute putting into possession thereof, immediately after such sale, of the purchaser or purchasers thereof, but the Company, for itself, and all who may claim through or under it, hereby waives the benefit of all such laws. And the Company, for itself and all who may claim through or under it, waives any and all right to have the estates comprised in the security intended to be created hereby marshalled upon any foreclosure of the lien hereof,

and agrees that the Trustee (as herein provided) or any court having jurisdiction to foreclose such lien, may sell (or order sold) the mortgaged and pledged property as an entirety.

[fol. 152] Section 13. The Company covenants that if default shall be made in the payment of any principal hereby secured when the same shall become payable, whether at maturity of said Bonds or by declaration as authorized by this Indenture, or in case of a sale as provided in Section 7 of this Article; then, upon demand of the Trustee, the Company will pay to the Trustee, for the benefit of the holders of the Bonds and coupons then outstanding hereunder the whole amount due and payable on all such Bonds and coupons for principal and interest, with interest upon the overdue principal and interest at the rate provided for; and in case the Company shall fail to pay the same forthwith upon such demand, the Trustee, in his name, and as Trustee of an express Trust, shall be entitled to sue for and to recover judgment for the whole amount so due and unpaid.

The Trustee shall be entitled to sue and recover judgment as aforesaid either before or after or during the pendency of any proceedings for the enforcement of the lien of this Indenture upon the mortgaged and pledged property, and in case of a sale of any of the mortgaged and pledged property and of the application of the proceeds of sale to the payment of debt hereby secured, the Trustee, in his name and as Trustee of an express Trust, shall be entitled to enforce payment of and to receive all amounts then remaining due and unpaid upon any and all of the Bonds and coupons then outstanding hereunder, for the benefit of the holders thereof, and the Trustee shall be entitled to recover judgment for any portion of the debt remaining unpaid, with interest. No recovery upon any such judgment, shall, in any manner or to any extent affect the lien of this Indenture upon the Mortgaged and pledged property, or any part thereof, or any rights, powers or remedies of the Trustee hereunder, or any liens, rights, powers or remedies of the [fol. 153] holders of the said Bonds, but such liens, rights, powers and remedies of the Trustee, and of the bondholders shall continue unimpaired as before.

Any monies collected or received by the Trustee under this Section 13 shall be applied by him, first, to the payment of his advances, expenses, disbursements and compen-

sation and the expenses, disbursements and compensation of his agents and attorneys, for all services incurred after default, and, second, toward the payment of the amounts then due and unpaid upon such Bonds and coupons in respect of which such monies shall have been collected, ratably and without preference or priority of any kind, according to the amounts due and payable upon such Bonds and coupons, respectively, at the date fixed by the Trustee for the distribution of such monies, upon presentation of the several Bonds and coupons and upon stamping such payments thereon, if partly paid, and upon surrender thereof, if fully paid, subject, however, to the provisions of Article Two, Section 6 hereof.

Section 14. All rights of action under this Indenture, or under any of the Bonds or coupons, may be enforced by the Trustee without the possession of any of the Bonds or coupons or the production thereof on any trial or other proceeding relative thereto, and any suit or proceeding instituted by the Trustee shall be brought in his name as Trustee and any recovery of judgment shall be for the equal benefit of the owners and registered holders of the Bonds and coupons.

Section 15. No holder of any Bond or coupon shall have any right to institute any suits, or proceeding in equity or at law for the foreclosure of this Indenture, or for the execution of any Trust hereof, or for the appointment of a Receiver, or any other remedy hereunder, unless such [fol. 154] holder shall have previously given to the Trustee written notice of such default and of the continuance thereof, as hereinbefore provided, or unless also the holders of forty-five per cent (45%) in principal amount of the Bonds then outstanding hereunder, shall have made written request to the Trustee and shall have offered him reasonable opportunity either to proceed to exercise the powers hereinbefore granted, or to institute such action, suit or proceeding in his name; and unless also they shall have offered to the Trustee adequate security and indemnity against the costs, expenses and liabilities to be incurred therein or thereby; and such notification, request and offer of indemnity are hereby declared, in every such case at the option of the Trustee, to be conditions precedent to the execution of the powers and Trust of this Indenture and to any action or cause of action for foreclosure or for the appointment

of a Receiver, or for any other remedy hereunder; it being understood and intended that no one or more holders of the Bonds or coupons shall have any right, in any manner whatsoever, to affect, disturb, or prejudice the lien of this Indenture by his or their action, or to enforce any right hereunder except in the manner herein provided, and that all proceedings at law or in equity shall be instituted, had, and maintained in the manner herein provided, and for the equal benefit of all holders of outstanding Bonds and coupons; provided, however, that nothing in this Article or elsewhere in this Indenture, or in the Bonds or in the coupons contained shall affect or impair the obligation of the Company, which is unconditional and absolute, to pay at the date of maturity therein expressed the principal of the Bonds, to the respective bearers or registered holders thereof, at the time and places in the Bonds expressed, or affect or impair the right, which is also absolute and unconditional, to enforce such payment; and that in case of the [fol. 155] designation for redemption of a part, but not all of the Bonds, the bearer or registered holder of any Bond so designated, without reference to the consent of the Trustee or the request of holders of other Bonds, may individually enforce payment of his Bonds so designated by any appropriate legal proceeding.

Section 16. Except as herein expressly provided to the contrary no remedy herein conferred upon or reserved to the Trustee or to the holders of the Bonds is intended to be exclusive of any other remedy or remedies, and each and every such remedy shall be cumulative and shall be in addition to every other remedy given hereunder or now or hereafter existing at law or in equity or by statute or otherwise.

Section 17. The Company may, if permitted by law, waive any period of grace provided in this Article Six.

Section 18. In case the Trustee shall have proceeded to enforce any right under this Indenture by foreclosure, entry, or otherwise, and such proceeding shall have been discontinued or abandoned for any reason, or shall have been determined adversely to the Trustee, then, in every such case the Company and the Trustee shall be restored to their former positions and rights hereunder, with respect to the mortgaged and pledged property, and all rights, remedies and powers of the Trustee shall continue as if no proceeding had been taken.

Article Seven

Evidence of Rights of Bondholders and Ownership of Bonds

Section 1. Any request, declaration or other instrument which this Indenture may require or permit to be signed and executed by the holders of the Bonds secured hereby, may be in any number of concurrent instruments of similar [fol. 156] tenor, and shall be signed or executed by such bondholders in person or by attorney appointed in writing. Proof of the execution of any such request or other instrument, or of a writing appointing any such attorneys, or of the holding by any person of the Bonds or coupons appertaining thereto, shall be sufficient for any purpose of this Indenture if made in the following manner:

(a) The fact and date of the execution by any person of such request or other instrument of writing may be proved by the certificate of any Notary Public, or other officer authorized to take acknowledgments of deeds to be recorded in the State in which he purports to act, that the person signing such request or other instrument acknowledged to him the execution thereof, or by an affidavit of a witness to such execution.

(b) The amount of Bonds transferable by delivery held by any person executing such request or other instrument as a bondholder, and the number thereof held by such person, and the date of his holding the same, may be proved by a certificate executed by any Trust Company, bank, bankers or other depository wherever situated, if such certificate shall be deemed by the Trustee to be satisfactory, showing that at the date therein mentioned such person had on deposit with or exhibited to such depository, the Bonds described in such certificate. The Trustee may, nevertheless, in his discretion, require further proof in cases where he deems further proof desirable. The ownership of registered Bonds shall be proved by the registry book.

Any request, consent or vote of the owner of any Bonds shall bind all future owners of the same instrument in respect of anything done or suffered by the Company or the Trustee in pursuance thereof.

[fol. 157]

Article Eight

Immunity of Officers, Directors and Stockholders

No recourse (except as the result of express contract) under or upon any obligation, covenant, stipulation, or

agreement contained in this Indenture of in any Bond or coupon issued hereunder or because of the creation of any indebtedness hereby authorized shall be had against any incorporator, stockholder, officer or director, past, present or future, of the Company, or of any successor corporation, either directly or through the Company or such successor corporation, by the enforcement of any assessment or by any legal or equitable proceeding by virtue of any Constitution, statute or other rule of law howsoever established; it being expressly agreed and understood that the Bonds and this Indenture and the obligations hereby created are solely corporate obligations and that no personal liability whatever (except as the result of express contract) shall attach to or be incurred by the incorporators, stockholders, officers or directors of the Company or of any successor corporation or any of them, because of the incurring of the indebtedness hereby authorized or under or by reason of any of the obligations, covenants, stipulations or agreements contained in this Indenture or any of the Bonds or coupons issued hereunder or implied therefrom; and that any and all rights and claims (except as the result of express contract) against every such incorporator, stockholder, officer or director, whether arising at common law or in equity, or created by any Constitution, statute or other rule of law, howsoever established, are hereby expressly released and waived as a condition of and as a part of the consideration for the execution and delivery of this Indenture and the issue of the Bonds and coupons.

[fol. 158]

Article Nine

Concerning the Trustee

Section 1. The Trustee accepts the Trust hereby established, but only upon the terms and conditions hereof, including the following, all of which shall bind the Company and the holders of the Bonds.

Section 2. The recitals of fact herein and in said Bonds contained shall be taken as the statements of the Company and the Trustee assumes no responsibility for the correctness of the same. The Trustee makes no representation as to the value of the mortgaged and pledged property, or any part thereof, or as to the title of the Company thereto, or as to the security afforded thereby and hereby, or as to the

validity of this Indenture, or of the Bonds or coupons issued hereunder, and the Trustee shall incur no responsibility in respect of such matters.

Section 3. The Trustee shall be under no duty to file or record or cause to be filed or recorded this Indenture as a mortgage, conveyance, or transfer of real or personal property, or otherwise, or to refile or re-record or renew the same, or to procure any further, other or additional instruments of further assurance, or to do any other act which may be suitable to be done for the better maintenance or continuance of the lien or security hereof, or for giving notice of the existence of such lien, or for extending or supplementing the same, or to see that any property intended now or hereafter to be conveyed in Trust hereunder is subject to the lien hereof. The Trustee shall not be liable for failure of the Company to insure or renew insurance or for responsibilities of insurers or for adequacy of such insurance or for failure of the Company to pay any tax or taxes in respect of the mortgaged and pledged property, or any part thereof, or otherwise, nor shall the Trustee be under [col. 159] any duty in respect to any tax which may be assessed against it or the owners of the Bonds outstanding hereunder in respect of the mortgaged and pledged property. The Trustee shall be under no responsibility or duty with respect to the disposition of the Bonds authenticated and delivered hereunder or the application of the proceeds thereof or the application of any monies paid to the Company under any of the provisions hereof.

Section 4. The Trustee may employ agents or attorneys in fact, in and about the execution of this Trust, and shall not be answerable for the default or misconduct of any agent or attorney appointed by him in pursuance hereof. Any such agent or attorney shall have been selected with reasonable care. The Trustee shall be liable only for gross negligence or willful or intentional default in the execution of any duty or Trust hereunder; provided that nothing herein contained shall alter or diminish the obligation of the Trustee to account for all monies and/or securities paid or delivered to him under the provisions of this Indenture, which obligation is absolute and unqualified except that the Trustee shall not be liable for losses by any depository selected by him, if such depository shall have been selected with reasonable care.

Section 5. The Trustee shall be under no obligation or duty to perform any act hereunder or to institute or defend any suit in respect hereof, unless properly indemnified to his satisfaction. The Trustee shall not be required to ascertain or inquire as to the performance of any of the covenants or agreements herein contained on the part of the Company. The Trustee shall not be required to take notice or be deemed to have knowledge, of any default of the Company hereunder, and may conclusively assume that there has been no such default unless and until he shall have been specifically notified in writing of such default by the Company by the holders of not less than forty-five (45%) percent in principal amount of the Bonds then outstanding hereunder. The Trustee shall not be under any obligation to take any action in respect of any default or otherwise, or toward the execution or enforcement of any of the Trusts hereby created, or to institute, appear in, or defend any suit or other proceeding in connection therewith, unless requested in writing so to do by the holders of forty-five percent (45%) in principal amount of the Bonds then outstanding hereunder; but this provision shall not affect any discretionary power herein given to the Trustee.

Section 6. Except as herein otherwise provided, any notice or demand which by any provision of this Indenture is required or permitted to be given or served by the Trustee on the Company shall be deemed to have been sufficiently given and served for all purposes by being deposited, postage prepaid, registered mail, addressed (until other address is filed by the Company with the Trustee) as follows: Gulf Coast Water Company, Bay City, Texas.

The Trustee shall not be bound to recognize any person as the holder of a Bond outstanding hereunder unless and until his Bond is submitted to the Trustee for inspection, if required, and his title thereto satisfactorily established if disputed.

Section 7. The Trustee shall be protected in acting upon any notice, resolution, request, consent, order, certificate, report, opinion, bond, or other paper or document believed by him to be genuine and to have been signed or presented by the proper party or parties. The Trustee may consult with counsel (who may be counsel for the Company) and the opinion of such counsel in writing shall be full and

complete authorization and protection in respect of any [fol. 161] action taken or suffered by him hereunder in good faith and in accordance with the opinion of such counsel.

Section 8. Upon any application for the authentication and delivery of Bonds hereunder or for the payment of any monies held by the Trustee under any provisions of this Indenture or upon any other application to the Trustee hereunder, the resolutions, certificates, statements, opinions, reports and orders required by any of the provisions of this Indenture to be delivered to the Trustee as a condition of the granting of such application may be received by the Trustee as conclusive evidence of any facts or matters therein set forth, and shall be full warrant, authority and protection to the Trustee acting on the fact thereof, not only in respect of the facts, but also in respect of the opinions therein set forth; and, before granting any such application, the Trustee shall not be bound to make any further investigations into the matters stated in any such resolution, certificate, statement, opinion, report or order, but if requested in writing so to do by the holders of not less than forty-five percent (45%) in principal amount of the outstanding Bonds and only if furnished with adequate security and indemnity against the cost and expenses of such examination, the Trustee shall make such further investigation as to him may seem proper; but he may in his discretion make any such independent inquiry or investigation as he may see fit. If the Trustee shall determine or shall be requested, as aforesaid, to make such further inquiry, he shall be entitled to examine the books, records and premises of the Company, either himself or by agent or attorney; and, unless satisfied, with or without such examination of the proof and accuracy of the matters stated in such resolution, certificate, statement, opinion, report, or order, he shall be under no obligation to grant the application. If after such examination or other inquiry, the [fol. 162] Trustee shall determine to grant the application, he shall not be liable for any action taken thereunder in good faith.

Section 9. The Trustee shall not be liable to the Company for interest on any monies received by him hereunder, except as may be agreed upon with the Company or otherwise herein expressly provided.

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Section 10. The Company shall pay to the Trustee from time to time a reasonable compensation for all services rendered by him hereunder after a completed default, and also all of his reasonable expenses, charges, counsel fees, and other disbursements, and those of his attorneys, agents and employees incurred in and about the administration and execution of the Trust hereby created after a completed default. In default of such payments by the Company and/or security for such indemnification, the Trustee shall have a lien therefor on the mortgaged and pledged property and the proceeds thereof prior to the lien of the Bonds and coupons issued hereunder.

Section 11. Whenever in the administration of the Trusts of this Indenture, the Trustee shall deem it necessary or desirable that a matter be proved or established prior to taking or suffering any action hereunder, such matter (unless other evidence in respect thereof be herein specifically prescribed) may be deemed to be conclusively proved and established by a certificate signed by the President or a Vice President and the Treasurer or an Assistant Treasurer of the Company, and delivered to the Trustee, and such certificate shall be full warrant and authority to the Trustee for any actions taken or suffered by him under the provisions of this Indenture upon the facts thereof; but in his discretion the Trustee may in lieu thereof accept other evidence of such fact or matter or may require such further [fol. 163] or additional evidence as to him may seem reasonable.

Section 12. The Trustee may become the owner of Bonds and coupons secured hereby, with the same right he would have if he were not Trustee.

Section 13. The Trustee, or any successor or successors hereafter appointed, or any of them, may, at any time resign and be discharged of the Trust hereby created by giving written notice to the Company and thereafter publishing notice thereof, specifying a date when such resignation shall take effect, once a week in a newspaper of general circulation published in the English language in Matagorda County, Texas, and such resignation shall take effect upon the date specified in such notice unless previously a successor Trustee shall have been appointed by the bondholders or the Company as hereinafter provided, in which event

such resignation shall take effect immediately on the appointment of such successor Trustee. Publication herein provided for shall be two consecutive weeks.

Section 14. The Trustee or any successor Trustee hereafter appointed may be removed at any time by an instrument or concurrent instruments in writing filed with the Trustee or his successor and signed by the holders of a majority in principal amount of the Bonds then outstanding hereunder.

Section 15. In case at any time the Trustee or any successor or successors hereafter appointed, shall resign, shall be removed, or shall refuse to act, or shall become incapable of acting, or shall be adjudged bankrupt or insolvent, or if a Receiver of the Trustee or of any successor or of his property shall be appointed, a successor or successors may be appointed by the holders of a majority in principal amount of the Bonds then outstanding hereunder, by an instrument [fol. 164] or concurrent instruments in writing signed and acknowledged by such bondholders or by their attorneys in fact duly authorized, and delivered to such new Trustee, notification thereof being given to the Company, and the predecessor Trustee; provided, nevertheless, that until a new Trustee shall be appointed by the bondholders as aforesaid, the Company, by instrument executed by order of its Board of Directors and duly acknowledged by its proper officers may appoint a Trustee to fill such vacancy until a new Trustee shall be appointed by the bondholders as herein authorized. The Company shall publish notice of any such appointment by it made once in each week for two (2) consecutive weeks, in a newspaper of general circulation published in the English language in Matagorda County, Texas. Any new Trustee appointed by the Company shall, immediately and without further act, be superseded by a Trustee appointed by the bondholders as above provided.

If in a proper case no appointment of a successor Trustee shall be made pursuant to the foregoing provisions of this Section 15, within two months after a vacancy shall have occurred in the office of Trustee, the holder of any Bond outstanding hereunder or any retiring Trustee may apply to any court of competent jurisdiction sitting in Matagorda County, Texas, to appoint a successor Trustee. Such court may thereupon after such notice, if any, as such

court may deem proper and prescribe; appoint a successor Trustee.

Any Trustee appointed under the provisions of this Section 15 in succession to the Trustee shall be either a National Bank organized under the Banking Laws of the United States of America having its principal office in the City of Bay City, Texas, or in the City of Houston, Texas, or a Trust Company organized under the laws of the State of Texas, with its principal office in the City of Bay City, [fol. 165] Texas, or in the City of Houston, Texas, and in either event having a capital or surplus aggregating to at least Two Hundred Thousand Dollars (\$200,000.00) if there be such National Bank or Trust Company fully able and willing to accept the Trust on reasonable terms, or such successor Trustee may be an individual residing within the State of Texas.

Section 16. Any Successor Trustee appointed hereunder shall execute, acknowledge and deliver to his or its predecessor Trustee, and also the Company, an instrument accepting such appointment hereunder, and thereupon such successor Trustee, without any further act, deed, or conveyance shall become fully vested with all the estate, properties, rights powers, trusts, duties and obligations of his or its predecessor in Trust hereunder, with like effect as if originally named as Trustee herein; but the Trustee ceasing to act, shall nevertheless, on the written request of the Company, or of the successor Trustee, execute, acknowledge and deliver such instruments of conveyance and further assurance and do such other things as may reasonably be required for more fully and certainly vesting and confirming in such successor Trustee all the right, title and interest of the retiring Trustee, which he or it succeeds, in and to the mortgaged and pledged property, and such rights, powers, trusts, duties and obligations, and the Trustee ceasing to act shall also, upon like request, pay over, assign and deliver to the successor Trustee any money or other property subject to the lien of this mortgage, which may then be in his or its possession. Should any deed, conveyance or instrument in writing from the Company be required by the new Trustee for more fully and certainly vesting in and confirming to such new Trustee such estates, rights, powers and duties, any and all such deeds, conveyances [fol. 166] and the instruments in writing shall, on request, be executed, acknowledged and delivered by the Company.

Section 17. Any Company into which any corporate Trustee acting hereunder may be merged or with which it may be consolidated, or any Company resulting from any merger or consolidation to which any such corporate Trustee shall be a party, provided such Company shall be a corporation organized under the laws of the United States of America, or the State of Texas, with the requisite capital or surplus recited in Section 15 of this Article, and shall have an office for the transaction of its business in the City of Bay City, Texas, or in the City of Houston, Texas, shall be the successor Trustee under this Indenture, without the execution or filing of any paper or the performance of any further act on the part of any other parties hereto, anything herein to the contrary notwithstanding.

Section 18. In case any of the Bonds contemplated to be issued hereunder shall have been authenticated but not delivered, any successor to the Trustee may adopt the certificate of authentication of the original Trustee or of any successor to him, as Trustee hereunder, and deliver the said Bonds so authenticated; and, in case any of said Bonds shall not have been authenticated, any successor to the Trustee may authenticate such Bonds either in the name of any predecessor Trustee hereunder or in the name of the successor Trustee, and in all such cases such certificate shall have the full force to which it is entitled as provided in said Bonds or in this Indenture.

Section 19. If at any time or times, in order to conform to any law of the State of Texas, or any other State, the Company or the Trustee shall so request, the Company and the Trustee shall have power to appoint, and shall unite in the execution, delivery and performance of all instruments [fol. 167] and agreements necessary or proper to constitute some person or persons approved by the Trustee, either to act as a Trustee or Trustees of all or any part of the property subject to the lien hereof jointly with the Trustee named herein, or his successor, or to act as a separate Trustee or Trustees of any such property.

Article Ten

Discharge of Mortgage

Section 1. The Trustee, and his successors, may, and upon request of the Company, shall, cancel and discharge the

lien of these presents and execute and deliver to the Company such deeds and instruments as shall be requisite to satisfy the lien hereof, and reconvey and transfer to the Company the mortgaged and pledged property, whenever all indebtedness secured hereby shall have been paid, including all proper charges, costs, advances and expenses of the Trustee hereunder. For this purpose bonds for the redemption of which money shall have been paid to the Trustee under any of the provisions of this Indenture, and matured Bonds for the payment of which monies shall have been deposited with the Trustee shall be deemed to be paid. No further release shall be necessary to satisfy and discharge the lien created by this Indenture nor any Indenture supplemental hereto, either as to the whole or any part of the mortgaged property, than a release executed by the Trustee, and such release or releases shall be conclusive evidence of the truth of the recitals contained therein, including that of full and final payment of said Bonds and the indebtedness secured hereby.

[fol. 168]

Article Eleven

Release of Mortgaged and Pledged Property

Section 1. Unless and until a completed default, as hereinbefore defined, shall have happened and the continuing, the Company may at any time and from time to time, without any release or consent by the Trustee, dispose of any portion of the equipment, machinery, tools, and other like property at any time held subject to the lien hereof, which shall have become unfit or undesirable for use, replacing the same immediately by new equipment, machinery, tools, and other like property which shall become subject to the lien of this Indenture to the same extent that the equipment, machinery, tools, and other like property disposed of was subject to the lien hereof.

Section 2. Unless and until a completed default, as hereinbefore defined, shall have happened and be continuing, the Company may sell any part of the mortgaged and pledged property, and the Trustee, if satisfied, in any way he may deem necessary, as to the sufficiency and adequacy of the consideration to be received, shall release the same from the lien hereof. Before any such release shall be made, or instrument to accomplish such release shall be delivered, the Trustee shall receive an instrument in writing, signed by the

President or one of the Vice Presidents of the Company, requesting such release, and

(1) A resolution of the Board of Directors of the Company, duly certified by the Secretary of the Company under its corporate seal, requesting such release.

(2) A certificate signed and verified by an engineer or other expert (who may be in the employ of the Company) satisfactory to the Trustee stating in substance as follows:

[fol. 169] (a) That such release is desirable in the conduct of the business of the Company and that the security hereby afforded will not be impaired by such release; and

(b) That the Company has sold or contracted to sell, the property so to be released for a consideration (which shall be stated) representing in the opinion of the signer its full value to the Company, which consideration shall be either all cash or partly cash and the balance obligations secured by purchase money first mortgage on the property released, not exceeding seventy-five percent (75%) of the consideration and maturing not later than the Bonds issued hereunder and in all respects satisfactory to the Trustee.

(3) The cash and obligations, if any, stated in such certificate to be the consideration for any such property so to be released.

(4) In case the consideration for the property to be released consists in part of obligations, an opinion of counsel (who may be counsel for the Company) satisfactory to the Trustee, to the effect that all such obligations are, in his or their opinion, valid obligations, and that the purchase money mortgage securing the same is sufficient to afford a lien upon the property to be released, subject to no other lien except taxes for the current year, not yet due.

Section 3. All obligations received by the Trustee for the release of property shall be held as pledged property under this Indenture. If the same are not transferable by mere delivery, they shall be endorsed in blank for transfer, or accompanied by proper instruments of assignment and transfer duly executed by the registered owners thereof. In case default shall be made in the payment of the principal or interest on any such obligations, the Trustee may, in his name, or in the name of his nominee or nominees,

cause any action, suit or proceeding to be instituted or [fol. 170] prosecuted to collect or enforce the same, or the Trustee may deliver the same to the Company under such restrictions as the Trustee deems proper, in order that the Company may institute and prosecute in its own name any such action, suit or proceeding. The Trustee shall have the right to collect the interest on and principal of all such obligations, without, however, any liability for failure to make any such collection. All such interest received while a default hereunder by the Company does not exist to the knowledge of the Trustee shall be forthwith paid over to the Company on its request. All such interest received while a default hereunder by the Company does exist to the knowledge of the Trustee, and all principal of such obligations collected by the Trustee shall be held by him as cash received for the release of property.

Section 4. All cash received by the Trustee for the release of property shall, at the option of the Company, to be exercised by its Board of Directors.

(a) Be turned over to it if it shall have previously erected, obtained, or acquired, or shall thereafter erect, obtain, or acquire property, machinery, or other equipment, if in the opinion of the Trustee such property, machinery or other equipment is of the fair value, or cost the Company (whichever is lower) at least the amount of cash so received by the Trustee the same to be covered by and become subject to the lien of this Indenture, and to be free and clear of all liens or other encumbrances, except the lien hereof; or

(b) Be held by the Trustee and applied by him to the payment of interest and/or principal of the Bonds and/or coupons maturing and becoming due and payable at the next interest payment date, and at successive interest payment dates, *and at successive interest payment dates*, until the same are exhausted. To the extent of the funds so held [fol. 171] by the Trustee, the Company shall be relieved from depositing with the Trustee the sums required to make such payments of interest and/or principal as hereinbefore in Section 13 of Article Four provided, but the Company shall, nevertheless, deposit any sums required to supplement those held by the Trustee, and at such time as all such funds so held by the Trustee shall have been paid out, the Company shall again deposit the amounts required as provided in Section 15 of Article Four.

Section 5. The resolutions, statements, opinions, certificates and other documents and the payments specified in this Article Eleven shall, in any and all cases, be sufficient authority to the Trustee for any action provided to be taken by the Trustee, and in relying thereon, without further evidence, the Trustee shall be fully protected. However, in his unrestricted discretion, and at the expense of the Company he may make any further inquiry or investigation as to any facts or matters stated in any such resolutions, statements, opinions, certificates and other documents, or as to any other facts or matters considered relevant by the Trustee, and unless satisfied in his absolute discretion as to the truth and accuracy of such documents, and that the Company is entitled to the release of property, or to the payment of cash, then requested by it, and that the rights of the holders of any of the Bonds at any time issued hereunder shall not be impaired thereby, the Trustee shall not be obliged to take any such action hereunder; provided further, that the Trustee shall be under no duty to make any such further inquiry or investigation, nor shall he be under any liability to any bondholder or to the Company, or to any other person, firm, or corporation whatsoever, for his failure so to do, or for any action taken as a result of such inquiry or investigation.

Section 6. No purchaser in good faith of any property which the Trustee has purported to release hereunder shall [fol. 172] be bound to ascertain the authority of the Trustee to execute the release or to inquire as to any facts required by the provisions hereof for the exercise of such authority.

Article Twelve

Consolidation, Merger and Sale

Section 1. Nothing contained in this Indenture, or in any Bond or coupon issued hereunder shall prevent any consolidation or merger of the Company with or into any other corporation, or corporations, or any sale, conveyance, or transfer, subject to the continuing lien of this Indenture, of the mortgaged property as an entirety, or substantially as an entirety, to any corporation lawfully entitled to acquire and operate the same; provided, however, that such consolidation, merger, sale, conveyance, or transfer shall be upon such terms as shall not impair the lien and security

of this Indenture, or any of the rights or powers of the Trustee, or of the bondholders hereunder, and that any such consolidation, merger, sale, conveyance or transfer, the due and punctual payment of the principal and interest of all the Bonds issued or which at any time be issued hereunder according to their tenor and the due and punctual performance and observance of all of the terms, covenants and condition- of this Indenture to be kept or performed by the Company, shall be expressly assumed by the corporation formed by such consolidation or resulting from such merger, or by the corporation acquiring by sale, conveyance or transfer, as an entirety or substantially as an entirety all the property subject to this Indenture.

Section 2. In case the Company shall sell, convey or transfer all of the Trust property to another corporation organized for the sole purpose of acquiring such property and continuing the business of the Company and not at the time of such sale, conveyance or transfer engaged in any [fol. 173] other business, such corporation (hereinafter called "successor corporation") may with the written consent of the Trustee succeed to and be substituted for the Company with the same effect as if such successor corporation had been named herein as party of the first part, upon executing and causing to be recorded an Indenture executed and delivered by it to the Trustee, satisfactory to the Trustee, whereby such successor corporation shall assume the due and punctual payment of the principal and interest of the Bonds secured hereby and the performance of all the covenants and conditions of this Indenture and all Indentures supplemental hereto on the part of the Company to be performed.

Section 3. The Trustee may, if he shall so elect, submit the matter of granting or withholding any consent or approval by him under the provisions of this Article to such experts or counsels as shall be satisfactory to him,—may, without any liability whatsoever to anyone, withhold any such consent or approval, if advised so to do by such experts or counsel and in case such approval or consent is withheld, such sale, conveyance or merger shall not be effective.

Section 4. The word "Company" wherever herein contained shall include the successor corporation and any or

der, certificate or resolutions of the Board of Directors, or officers of the Company, provided for in this Indenture may be made by like officials of the successor corporation:

Section 5. The Trustee may receive the opinion of counsel (who may be counsel to the Company) satisfactory to him as conclusive evidence that any Indenture or Indentures executed by any successor corporation by which such successor corporation shall assume the due and punctual payment of the principal and interest of all the Bonds issued or which may at any time be issued hereunder and the performance and observance of all the terms, covenants [fol. 174] and conditions of this Indenture, as required by Section 1 of this Article Twelve is sufficient for the purposes of this Article Twelve.

Article Thirteen

Miscellaneous

Section 1. Nothing in this Indenture, expressed or implied, is intended or shall be construed to confer upon or to give to any person or corporation, other than the parties hereto, and the holders of the Bonds outstanding hereunder, any right, remedy or claim under or by reason of this Indenture or any covenant, condition or stipulation hereof; and all the covenants, stipulations, promises and agreements in this Indenture contained by and on behalf of the Company shall be for the sole and exclusive benefit of the parties hereto, and of the holders of the Bonds and of the coupons outstanding hereunder.

Section 2. Whenever in this Indenture any of the parties hereto is named or referred to, this shall be deemed to include the successors or assigns of such party, and all the covenants and agreements in this Indenture contained by or on behalf of the Company or by or on behalf of the Trustee shall bind or inure to the benefit of the respective successors and assigns of such parties, whether so expressed or not.

Section 3. This Indenture may be simultaneously executed in any number of counterparts, and all said counterparts executed and delivered, each as an original, shall constitute but one and the same instrument.

Section 4. Payment to the Trustee of the principal of or interest on any Bond for the account of the holder or

holders thereof shall, to the extent of such payment, ex-[fol. 175] onerate the Company from liability to the holder or holders thereof.

In Witness Whereof, Gulf Coast Water Company, party hereto of the first part, has caused its corporate name to be hereunto affixed, and this instrument to be signed and sealed by its President, or one of its Vice Presidents, and its corporate seal to be attested by its Secretary, for and in its behalf, and J. C. Lewis of Bay City, Texas, party hereto of the second part, in token of his acceptance of the Trust hereby created, has hereunto signed his name, this 18 day of November, A. D. 1931.

Gulf Coast Water Company, by E. J. Crofoot, President. J. C. Lewis, Trustee.

Attest: R. G. Wertz, Secretary. (Seal—corporate.)

Attested, signed, sealed, executed, acknowledged and delivered by Gulf Coast Water Company in the presence of Glenn W. Stephens, Robert B. Holland.

Signed, executed, acknowledged and delivered by J. C. Lewis in the presence of Glenn W. Stephens, Robert B. Holland.

(Said instrument was duly acknowledged in statutory form by E. J. Crofoot and R. G. Wertz, President and Secretary, respectively, of Gulf Coast Water Company, a corporation, before Lola E. Williams, Notary Public, Matagorda County, Texas, on November 19, 1931.)

(Said instrument was duly acknowledged in statutory form by J. C. Lewis before Lola E. Williams, Notary Public, Matagorda County, Texas, on November 19, 1931.)

[fol. 176]

Certificate of Record

THE STATE OF TEXAS,
County of Matagorda:

I, Ruby Hawkins, Clerk of the County Court in and for said County do hereby certify that the foregoing instrument of writing, with its certificate of authentication was filed for record in my office the 21st day of November, 1931 at 12 o'clock M., and duly recorded the 27th day of Novem-

ber, 1931, at 1:15 o'clock P. M. the D. T. Records of said County in Vol. 4 on page 311 et seq.

Witness my hand and seal of County Court of said County, at office in Bay City, Texas, the day and year last above written.

Ruby Hawkins, Clerk County Court, Matagorda County, Texas. By —, Deputy. (Seal.)

Certificate of Record

THE STATE OF TEXAS,

County of Wharton:

I, F. L. Kral, Clerk of the County Court of Wharton County, certify that the foregoing instrument of writing, with its certificate of authentication was filed for record in my office on the 15 day of Dec., 1931, at 11:40 o'clock A. M. and duly recorded on the 26 day of Dec. 1931 at 11:40 o'clock A. M. in the D. T. Records of Wharton County, Volume 20 page 163-244.

Witness my hand and seal of office, at office in Wharton, Texas, the day and year last above written.

F. L. Kral, Clerk, County Court, Wharton County, Texas. By Rosa C. Stinsang, Deputy. (Seal.)

No. 1412 Law—Filed: June 24, 1937. Maxey Hart, Clerk, By Joe Steiner, Deputy. Ptff's Exhibit 28 CHP.

[fol. 177]

PLAINTIFF'S EXHIBIT No. 29

The plaintiff next introduced Bond No. 15 of the Bonds secured by the Deed of Trust of Gulf Coast Water Company to J. C. Lewis, Trustee, dated November 18, 1931, which bond was in the form of the bonds set forth in the Deed of Trust, and it is agreed that the balance of the bonds were in the same general form as No. 15, except for appropriate change in numbers, dates, amount of bond and date of maturity.

V. L. LeTULLE, the plaintiff, being sworn testified as follows:

Direct Examination.

By Mr. Bruce:

My name is V. L. LeTulle, and I am the plaintiff in these two cases numbers 1412 and 1413. When I got the bonds

of the Gulf Coast Water Company I tried to sell them. In trying to sell the bonds I came to Houston and went to my banker at Houston and talked to him; he had been my banker for a long time and I had always done business with him, and I told him what I had done and that I wanted to sell the bonds and asked him if there was anybody there who bought bonds, and he sent me to Neuhouse & Company and another Company there, and he took the telephone down and talked to those people. I tried to sell the bonds, and he told me there was no sale for irrigation bonds then; he had telephoned these two Companies and they said they could not handle them. At that time I offered to take fifty cents on the dollar for them, but I was not able to get that.

[fol. 178] Cross-examination.

By Mr. Gibson:

I testified that I offered to take fifty cents on the dollar for our bonds at any time when I first got them. You all have got the dates that I entered into this contract to sell the Gulf Coast Irrigation Company to the Gulf Coast Water Company, and I have not, but I think it was sometime in 1931, but I am not sure as to the date.

I had some prior negotiations relative to this contract. Mr. Devant can tell more about it than I can; he drew up some kind of contract to do certain things and they were not able to carry them out and it was called off. We had that contract; Mr. Devant drew it up. It was with the Continental Service Company. That was before this contract here was made and they were not able to carry it out, and then we wrote up another contract and that is the contract the deal was closed on. I do not know who the other contract was by name, whether it was the Continental Public Service or Mr. Crofoot or who made that, but Mr. Devant can state and explain all that to you; if you want to know anything about it, he has been my attorney for a long time. I received a payment of \$10.00 on that contract of January 1931; and gave it back to them when we entered into the other contract. I would not swear to the date of the contract, sometime in 1931; I do not know whether it was in the early part or not; the records will show when it was, I do not remember. I did not receive anything on the first contract; there was no contract made entirely because they were not able to carry out the first contract, at least they

did not do it, but I don't know why. I do not know why they didn't go on with the contract; we tore up that contract and wrote another one. I received payment in bonds on this contract here, that Mr. Bruce had a while ago. I would not say that was in the early part of 1931, but I do [fol. 179] not remember for sure; I do not try to remember those things, just keep them in the books. I would not swear how many of the bonds were paid off to me; the Trustee could tell you that; he is right over there, the man that received the money. I could not tell you whether the books would show that or not; I don't know.

E. J. CROFOOT, a witness for the plaintiff, being sworn, testified:

Direct Examination.

By Mr. Bruce:

My name is E. J. Crofoot. I heard the testimony and know of this transaction in November, 1931, whereby the Gulf Coast Irrigation Company transferred its assets to the Gulf Coast Water Company. At that time I was connected with the Gulf Coast Water Company; I was the President of the Company; I attended to the issuance of the bonds at the time. Up to the year 1931, I had worked for a bond company both in the buying and selling of bonds and kept up with the values of securities; I worked in that capacity for about five years. I knew the character of the bonds of the Gulf Coast Water Company. My opinion is that the fair and reasonable market value of those bonds in November, 1931, would be about sixty cents on the dollar.

Cross-examination.

By Mr. Gibson:

If you mean by "similar bonds" irrigation bonds, I will qualify my answer by saying I had not had experience in selling irrigation bonds. I was familiar with the assets back of these bonds. The Gulf Coast Water Company had a good income during the year 1931. In 1932 the income was comparatively good, and since 1932 we have had to wipe off [fol. 180] many thousands of the income that came in 1932. Along about the time of the issuance of these bonds there was an appraisal made of the assets of the Company. I

was an officer of the Company at the time the appraisal was made. I think that appraisal was made by J. Samuel Hart; the bonds were first mortgage bonds. I have a copy of this appraisal, but haven't got it with me here; I do not know what it shows. I do not remember what it shows now. I am sure that this appraisal was approximately as much as \$800,000.00; I am sure it was that much. The appraisal was such that the Company did not hesitate to issue this amount of bonds on it. The Gulf Coast Water Company is not a subsidiary to the Continental Public Service Company; it probably was in some parts of 1931. I do not remember that now. I don't remember the dates. We were in the process of organization at that time, and it occurs to me now that the Continental Public Service Company was organized sometime in 1931, now as to the date or month, I do not remember that part. It is my opinion now that all of the stock of the Gulf Coast was not owned by the Continental Public Service Company; I really do not know without refreshing myself as to that phase. I heard the testimony of Mr. LeTulle that he entered into a contract with the Continental Public Service Company in 1930, that is between the Gulf Coast Irrigation Company and the Public Service Company, but I do not remember that particular contract. I do not remember that contract at all. There was a contract between B. E. Beckmann & Company and the Gulf Coast Irrigation Company; my recollection is that was in December, 1930, sometime. I am not familiar with the terms of that contract at this time. I do not have a copy of that contract in my possession; let me qualify that; we would have to search my files to be sure of that. Certainly a copy of that contract would be in the [fol. 181] hands of B. E. Beckmann & Company I would say. I have answered as to whether the Continental Public Service Company has a copy to the best of my knowledge; I don't know. I could search the records and see, but I do not know whether or not they have a copy of it at this time.

Redirect Examination.

By Mr. Bruce:

My Company would not have paid \$850,000.00 for these irrigation properties in 1931. The reason we would pay \$50,000.00 cash and \$750,000.00 in bonds, when the bonds were worth only sixty cents on the dollar was, as I recall

that at this time we had an option to take some of the bonds down at a discount. We would not have paid as much in cash for the property as we would a small amount of cash and a large amount of bonds. With reference to the contract Mr. Gibson was talking about, this old contract in 1931, this final contract did away with all prior contracts that we had. It is correct that the old contract was thrown away and we went into an entirely new and different contract all together.

Recross-examination.

By Mr. Gibson:

No, sir, I do not know whether I have a copy of that old original contract in our files or not. My official position now with the Company is Vice-President. This Company operates irrigation, supplies, and furnishes water to the farms for the production of rice. It now has some farming operations, but at that time it did not; it received from the Gulf Coast Irrigation Company pumping plants and canals; it is a private corporation,—I mean not a public water improvement district. I cannot say that my Company in December, 1930, as a part of its organization issued 10,000 [fol. 182] shares of its stock in Class A stock, common preferred stock, and 371,000 part of its shares of common stock, based on the par value of its bonds on its organization and gave its contract to purchase certain property for \$800,000.00 to assure the organization under its contract; I do not remember about that particular transaction. I think I could go to the records and find out whether that is true or not, but I am not able at this time to answer that question.

J. C. LEWIS, a witness for the plaintiff, being sworn, testified:

Direct Examination.

By Mr. Bruce:

My name is J. C. Lewis, and I live at Bay City, Texas. I am the Vice-President of the First National Bank at Bay City. I have been in the banking business about twenty-five years. I have handled our investment accounts and have had that experience in keeping up with the market condition on stocks and bonds; that investment account has

run up in the millions during the time I have been with the bank; I have been handling that kind of work nearly ten years. I am familiar with the property of the Gulf Coast Irrigation Company that was transferred to the Gulf Coast Water Company. I have known Mr. LeTulle and this general irrigation property for more than ten years. I think sixty cents on the dollar would be a fair and reasonable market price for those \$750,000.00 worth of Bonds issued the Gulf Coast Water Company.

Cross-examination.

By Mr. Gibson:

I was familiar with the property of the Gulf Coast Irrigation Company. Their income was passable, some years [fol. 183] they made money and some years they lost money. I do not remember what their income was around 1931; I do not recall that; I was not connected with the Company and do not know what it was; I do not know whether they made or lost money at that time. My reason for saying the bonds were worth about sixty cents was because at that time Bonds were very low, and I happened to help sell some bonds along about that time. I did not know about the appraisal had along about that time. I did not know about an option the Company had to redeem these bonds within a period of nine months; I do not know how the first fifteen of the bonds were to be paid for; I just knew there were \$750,000.00 in bonds. I do not think my bank ever loaned any money on those bonds. I just don't remember any default in the payment; there may have been a slight default in some of them, but I do not remember it.

W. E. DEVANT, a witness for the plaintiff, being duly sworn, testified:

Direct Examination.

By Mr. Bruce:

My name is W. E. Devant; I am a practicing attorney and live at Bay City, Texas; I represent the plaintiff, Mr. V. L. LeTulle, in these cases. I represented the Gulf Coast Irrigation Company in 1931. I was present this morning

when you offered the minutes and other papers and stock book and Director's meeting of the Gulf Coast Irrigation Company for November, 1931. I saw the one offered in evidence. I was present at the time of the holding of this meeting of the Gulf Coast Irrigation Company and at the execution of the minutes evidencing the action of the meeting, and I observed that these minutes were the only minutes had at that meeting; or at any time since then. In other [fol. 184] words, these are the only and original minutes that were kept in those meetings; and it was done in connection with the re-organization and the cancellation of the charter, which immediately followed. Those minutes have been in my safe ever since November, 1931. In connection with that meeting the Gulf Coast Irrigation Company was immediately dissolved and the stock surrendered and cancelled; that was done immediately.

Cross-examination.

By Mr. Gibson:

I have no other minutes in my safe prior to the first date of these minutes. I know that there were minutes kept back throughout the years, but there were some put in the warehouse and were misplaced, and in order to prevent that very thing I took these minutes and put them in my safe and kept them. As to what the minutes would reflect for December, 1930, I do not know; and I do not know where those minutes are. The Corporation kept minutes that year as well as in 1931 I am sure. I do not think that there ever was a contract between the Continental Service Company and us. There was a contract between Mr. LeTulle and the B. E. Buckmann & Company. I think I have an office copy of that contract in my files. I will be glad to produce that if I can find it; I will look and see if I can find it. I have not had occasion to look for it for the reason that it has been out of existence, and I am doubtful if I can find my office copy; that has been back some eight or nine years, but I will make a search to see.

Mr. Bruce: We have no further evidence.

[fol. 185] **The Court:** Plaintiff rests Counsel.

Mr. Gibson: We have no evidence except some photostats, but I feel we ought to have some records here if it is pos-

sible to get them and would like permission to continue the case for the purpose of subpoenaing the records.

The Court: What records?

Mr. Gibson: We want the records of the payment of Mr. LeTulle in January, 1931, of the transfer of the Gulf Coast Irrigation stock, and we want Mr. Devant to see if he can locate a copy of the contract with Buckmann & Company.

Mr. Bruce: May I suggest if he will make a list of what he wants, we will waive notice.

The Court: I will recess this case over until the 5th of July, at San Antonio, and if you have any evidence I will hear it at that time; I assume it will be short, and will hear your arguments at that time and if you have your briefs ready then I would like to go over them; we will recess until July 5th at 9:30 a. m., and meet again in San Antonio.

July 5th, 1937.

(NOTE.) A Motion for Continuance was made by Defendant and overruled.

[fol. 186]

[Title omitted]

DEFENDANT'S REQUEST FOR SPECIAL FINDINGS OF FACT AND CONCLUSIONS OF LAW

Comes Now the defendant, and considering the facts hereinafter stated to be proven, requests the Court to find the facts as stipulated by the parties in both causes 1412 and 1413, and, that he make the following—

Additional Findings of Fact

With respect to cause number 1412 and the additional income tax and interest paid by plaintiff as transferee of the assets of the Gulf Coast Irrigation Company for the fiscal period beginning April 1, 1930, and ending March 31, 1931—

1. That the transfer of the stock of the Markham Irrigation Company by the plaintiff, V. L. LeTulle, to Gulf [fol. 187] Coast Irrigation Company in the year 1930 was made after the foreclosure by V. L. LeTulle upon the assets of the Markham Irrigation Company.

2. That the plaintiff, himself, testified that this stock never was worth "anything much".

3. That the transaction with respect to the item of \$124,856.22, loss claimed on account of the sale of the Markham Irrigation Company stock, took place during affiliation with the Gulf Coast Irrigation Company and was an intercompany transaction.

4. That the evidence in respect to this item adduced by plaintiff confirms the conclusion of the Commissioner of Internal Revenue.

From all of which defendant requests the Court to make the following Conclusions of Law in respect thereto:

1. That the assessment of the additional tax and interest of \$9,423.91 for the fiscal period beginning April 1, 1930, and ending March 31, 1931, was the proper and legal assessment in all respects.

2. That under the applicable sections of the Revenue Act plaintiff was not entitled to carry over a loss for a previous year.

3. That the evidence adduced at the trial confirms the conclusion of the Commissioner of Internal Revenue.

4. Plaintiff is not entitled to recover and judgment should be for the defendant on this item.

As to the fiscal period beginning April 1, 1931, and ending November 30, 1931, (number 1412), wherein additional tax on principal and interest in the sum of \$40,919.30 was determined and assessed by the Commissioner of Internal Revenue, and the calendar year 1931 (number 1413), [fol. 188] wherein plaintiff sues individually and in behalf of his deceased wife, the defendant requests the Court to make the following—

Additional Findings of Fact

1. That the transaction whereby the assets of the Gulf Coast Irrigation Company were transferred to the Gulf Coast Water Company was carried out in ordinary form of purchase and sale, and, in addition to the monetary consideration, the plaintiff, V. L. LeTulle, bound himself not

to enter into a like business—either individually or through a corporation for a period of thirty years.

2. That V. L. LeTulle, plaintiff herein, retained no interest in the affairs of the Gulf Coast Water Company after the transfer of the assets of the Gulf Coast Irrigation Company to it and receipt by him of cash and bonds in payment for said assets.

3. That the assets transferred by the Gulf Coast Irrigation Company and by plaintiff to the Gulf Coast Water Company by warranty deed and upon which a mortgage was given plaintiff and Gulf Coast Irrigation Company by the transfer were of ample value to meet the payments of the bonds as they came due.

4. That the income of the Gulf Coast Irrigation Company for the year 1931, as shown by plaintiff's Exhibit 16, contract of November 4, 1931, and Exhibit D thereto, was the net amount of \$192,125.52, and though the year 1931 was not what would be considered a prosperous year, the income of the Gulf Coast Irrigation Company shows that it was in good condition financially.

5. That the assets of the Gulf Coast Irrigation Company and the income therefrom upon which plaintiff retained a lien for the payment of the bonds in question were more [foi. 189] than sufficient to take up the bonds as they became due.

6. That plaintiff's exhibits, consisting of conference reports and memoranda by various internal revenue agents relative to recommendations of the said agents and proposed changes as to the tax liability of plaintiff, have no probative value in determining the issues presented here, and the only documents of any evidentiary value are the letters of the Commissioner of Internal Revenue (so-called sixty-day letters) advising plaintiff of his tax liability, and upon which the assessments finally made by the Commissioner of Internal Revenue were determined.

From all of which the defendant requests the Court to make the following—

Conclusions of Law

1. That the transaction whereby the assets of the Gulf Coast Irrigation Company were transferred to the Gulf

Coast Water Company for cash and bonds was a sale and not a reorganization as defined by Section 112 (i) of the Revenue Act of 1928.

2. That V. L. LeTulle did not acquire a definite, material and substantial interest in the affairs of the Gulf Coast Water Company in the disposition by him in 1931 of the stock of the Gulf Coast Irrigation Company, which interest represented a substantial part of the value of said shares of stock disposed of by him.

3. That the taxable profit derived by V. L. LeTulle in 1931 from the disposition of all the shares of the Gulf Coast Irrigation Company was not limited to the amount of cash received by him in 1931, but also included the then value of the bonds received in lieu of cash under the provisions of Section 112 (c) (1) of the Revenue Act of 1928.

[fol. 190] 4. That the taxable profit derived in 1931 by V. L. LeTulle from the disposition of shares of stock of the Gulf Coast Irrigation was the difference between the sum of the cash, the value of the bonds of the Gulf Coast Water Company received in 1931, less the cost to him of said shares of stock in the Gulf Coast Irrigation Company.

5. That plaintiff was taxable upon both the cash and the fair market value of the bonds received by him in payment of said transaction.

6. That the fair market value of the \$600,000 in bonds on the date of the transfer was 75 per cent of the face value thereof.

7. That with the exceptions of the \$40,000 commission and the difference in value of real estate admitted by the parties, the determination of the Commissioner of Internal Revenue with respect to the profit on the said transfer was correct.

8. That judgment should be for the plaintiff for only the difference between the tax on the \$40,000 commission paid out of the proceeds of said bonds and assigned prior to the sale thereof, together with the difference in the value of real estate determined by the Commissioner at \$10,000 and stipulated to be \$3,050.

In the alternative, in the event the Court should find that the transaction where by the assets of the Gulf Coast Irri-

gation Company were transferred to the Gulf Coast Water Company was a nontaxable transaction, as contended by the plaintiff in so far as the bonds are concerned, it is requested that the Court make the following—

[fol. 191]

Findings of Fact

1. That the profit determined by the Commissioner of Internal Revenue was correct as to all items except the profit on the proceeds of the bonds.
2. That the fair market value of the bonds was as heretofore set out, and that the Court make the following—

Conclusions of Law

1. Plaintiff, in addition to judgment indicated above, is entitled to additional judgment for the amount assessed and collected by the Commissioner, based upon the fair market value of said bonds, in respect to the income tax determined and collected as a result of holding the profit on the bonds taxable.

2. That as to all other items the determination of the Commissioner was correct.

W. R. Smith Jr., United States Attorney; H. W. Moursund, Assistant United States Attorney, Attorneys for Defendant.

(Endorsements): Nos. 1412, 1413 Law. Filed August [fol. 192] 2, 1937. Maxey Hart, Clerk, by T. H. Thompson, Deputy.

IN UNITED STATES DISTRICT COURT FOR THE WESTERN
DISTRICT OF TEXAS, AUSTIN DIVISION

Nos. 1412 1413 Law

[Title omitted]

COURT'S FINDINGS OF FACT AND CONCLUSIONS OF LAW—Filed
April 29, 1938

The above entitled cause heretofore came on duly and regularly for trial and hearing before this Court, sitting without a jury, a trial by jury having been duly and regu-

larly waived by the respective parties hereto in writing filed with this Court and the Clerk thereof; and both plaintiff and defendant appeared by their respective attorneys; both oral and documentary evidence having been introduced at the trial thereof on behalf of the respective parties here- [fol. 193] to, and the evidence being closed, the cause submitted to this Court for its decision and determination, and the Court being duly advised in the premises, finds the facts as stipulated by the parties in causes 1412 and 1413, respectively, and makes the following:

Additional Findings of Fact

With respect to cause number 1412 and the additional, income tax and interest paid by plaintiff as transferee of the assets of the Gulf Coast Irrigation Company for the fiscal period beginning April 1, 1930, and ending March 31, 1931, the court finds:

1. There is a conflict in the evidence as to whether the stock of the Markham Irrigation Company was transferred by the plaintiff, V. L. LeTulle, to the Gulf Coast Irrigation Company before the foreclosure by the said LeTulle upon the assets of the Markham Irrigation Company. The stock book of the Markham Irrigation Company indicates that the stock was issued in the name of the Gulf Coast Irrigation Company in 1928. There is, however, no evidence to show that the stock was either delivered to or accepted by the Gulf Coast Irrigation Company at that time. On the other hand, Mr. LeTulle testified in person that the stock was transferred to the Gulf Coast Irrigation Company after the foreclosure. The ledger sheet of the Gulf Coast Irrigation Company indicated that credit was given to LeTulle for the stock after the foreclosure. On this state of the record, the Court will find that plaintiff has failed to discharge the burden resting on him to show by a preponderance of the evidence that the stock of the Markham Irrigation Company had been transferred to and accepted by the Gulf Coast Irrigation Company prior to the time of the foreclosure upon its assets.

[fol. 194] 2. During the year 1928 and thereafter, the stock of the Markham Irrigation Company possessed very little, if any, substantial value.

3. That the transaction with respect to the item of \$124,856.22, loss claimed on account of the sale of the Markham Irrigation Company stock, took place during affiliation with the Gulf Coast Irrigation Company and was an intercompany transaction.

4. That the evidence in respect to this item adduced by plaintiff confirms the conclusion of the Commissioner of Internal Revenue.

From all of which the Court makes the following:

Conclusions of Law

1. That the assessment of the additional tax and interest of \$9,423.91 for the fiscal period beginning April 1, 1930, and ending March 31, 1931, was the proper and legal assessment in all respects.

2. That under the applicable sections of the Revenue Act plaintiff was not entitled to carry over a loss for a previous year.

3. That the evidence adduced at the trial confirms the conclusion of the Commissioner of Internal Revenue.

4. Plaintiff is not entitled to recover and judgment should be for the defendant on this item.

As to the fiscal period beginning April 1, 1931, and ending November 30, 1931 (number 1412), wherein additional tax on principal and interest in the sum of \$40,919.30 was determined and assessed by the Commissioner of Internal Revenue, and the calendar year 1931 (number 1413), wherein plaintiff sues individually and in behalf of his deceased wife, the court makes the following:

[fol. 195] Additional Findings of Fact

1. In November, 1931, in pursuance of the plan of reorganization, Gulf Coast Irrigation Company transferred substantially all of its properties to Gulf Coast Water Company for \$50,000 cash and \$750,000 of bonds of the latter Company, and then dissolved and distributed the bonds and all of its other assets to plaintiff, its sole stockholder, in cancellation of its stock. Plaintiff received from Gulf Coast Irrigation Company cash and other property; exclusive of the bonds, of a value of \$94,762.17 and as transferee of said Company became liable for \$123,674.04 of its liabilities, all

as more fully set out in the computations hereinafter set forth.

2. The fair market value of the first maturing \$150,000 of bonds on the date of their transfer to plaintiff was their face value and of the other \$600,000 was 75% of their face value.

3. Plaintiff had acquired the 2,660 shares of the capital stock in the following order of time: 1,000 shares (consisting of 510 and 490 shares) acquired more than two years prior to November, 1931, and 150 shares and 1,510 shares in November, 1931. Any taxable income allocated to the 1,000 shares is capital gains and to the 1,660 shares is ordinary income.

4. The total cost to plaintiff of the stock in Gulf Coast Irrigation Company, including his original cost plus the liabilities he became liable for on its dissolution, is as follows:

[fol. 196]

Shares	Original Cost	Liabilities	Total Cost
510	\$18,057.12	\$23,711.94	\$41,769.06
490	40,350.00	22,782.06	63,132.06
150	15,000.00	6,974.10	21,974.10
1,510	114,537.91	70,205.94	184,743.85
<hr/>			
2,660	\$187,945.03	\$123,674.04	\$311,619.07

The \$750,000 of bonds are allocated to the 2,660 shares in the order acquired by plaintiff and on the following bases:

Shares	Cost	Bonds	Cost basis per \$1,000
1,000	\$104,901.12	1 to 17	\$250,000.00
		18	31,954.89
<hr/>			
			281,954.89
1,660	206,717.95	18	\$372,049
		19 to 27	18,045.11
			450,000.00
<hr/>			
			468,045.11
			442,9444

From all of which the Court makes the following:

Conclusions of Law

1. The transaction in November, 1931, under which Gulf Coast Irrigation Company transferred substantially all of its properties to Gulf Coast Water Company for \$50,000.00 in cash and \$750,000 in bonds of Gulf Coast Water Company, and dissolved and distributed its assets to plaintiff as its sole stockholder, was a tax free re-organization and Gulf Coast Irrigation Company realized no taxable gain on account thereof. For the fiscal period ended November 21, 1931, Gulf Coast Irrigation Company had no taxable income in excess of that reported upon its original return and paid [fol. 197] thereon, and the additional tax paid by plaintiff as transferee of Gulf Coast Irrigation Company for said period was erroneously assessed and collected, and plaintiff is entitled to recover from the defendant the \$36,422.83 tax and \$4,496.47 interest thereon, which plaintiff paid to the defendant on June 21, 1934, with interest on both of said sums at the rate of six per cent (6%) per annum from June 21, 1934.

2. Upon the dissolution and liquidation of Gulf Coast Irrigation Company, plaintiff received a taxable gain only to the extent of the cash and fair value of other property received by him, exclusive of the bonds, of a total value of \$94,762.17.

3. The taxable profit to plaintiff and his wife on the liquidation of Gulf Coast Irrigation Company and the income tax liability of plaintiff and his wife for the calendar year 1931 are to be computed as follows:

Profit on Liquidation of Gulf Coast Irrigation Company

Consideration received:

(a) Bonds:

\$150,000 at face value	\$150,000.00
\$600,000 at 75% of face value	450,000.00

(b) Cash and Property

A. Reported as ordinary dividend	\$15,339.78
B. Cash (net)	42,950.43
C. Notes receivable	33,421.96
D. Real Estate	3,050.00

Total

	94,762.17
	<u>\$694,762.17</u>

[fol. 198] Less Liabilities:

E. Accounts payable	\$55,000.00	
F. Advalorem taxes in dispute	6,787.85	
G. Bryan Jackson Account	13,547.86	
H. Revenue Stamps	375.26	
J. Income taxes of Gulf Coast Irrigation Company	7,963.07	
K. Commissions	40,000.00	
		<u>123,674.04</u>

Net amount received	571,088.13
Cost of stock in Gulf Coast Irrigation Company	<u>187,945.03</u>

Profit	\$383,143.10
Taxable Profit	94,762.17
Taxable profit allocated to 1,660 shares held less than two years	59,137.30
Taxable profit allocated to 1,000 shares held over two years (capital gain)	35,624.87

Computation of Tax

Net income per return	82,296.38
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Deduct (as included in return and included below):

(1) Profit on liquidation of Gulf Coast Irrigation Co.	76,358.40	
(2) Dividend reported as ordinary income (part of liquidating distribution)	15,339.78	
		<u>91,698.18</u>

Deficit

-9,401.80

Add:

(3) Reduction in loss on ranch	3,245.00
(4) Reduction in interest	6,906.17
(5) Bad debts disallowed	1,773.73

[fol. 199]

(6) Profit on liquidation of
Gulf Coast Irrigation
Co.:

Capital gain 35,624.87

Ordinary income 59,137.30

(7) Profit on payment in
1931 of Bonds 1 to 7:Amount
received 70,000.00

Cost basis 26,045.53

43,954.47

(8) Profit on payment in
1931 of Bond 8:Amount
received 6,648.30

Cost basis 2,473.69

4,174.61

154,816.15

Taxable income on community basis 145,414.35

One-half to each spouse 72,707.18

Less capital gain ($\frac{1}{2}$ of 35,624.87) 17,812.43

Balance taxable at ordinary rates 54,894.75

Less:

Dividends 2,672.50

Personal exemption and credit
for dependents 2,150.00

4,822.50

Balance subject to normal tax 50,072.25

Normal tax $1\frac{1}{2}\%$ on 4,000.00 60.00

Normal tax 3% on 4,000.00 120.00

Normal tax 5% on 42,072.25 2,103.61

Surtax on 54,894.75 3,645.27

Tax at $12\frac{1}{2}\%$ on 17,812.43 2,226.55

Total 8,155.43

Earned income credit 28.25

Income tax liability 8,127.18

[fol. 200] Income tax paid:

On original return	3,110.84	
Additional assessment paid		
June 9, 1934	35,642.16	
		<u>38,753.00</u>
Overpayment by plaintiff for himself and wife in each case		30,625.82
30625.82/35642.16 of interest of 4,692.07 paid June 9, 1934		<u>4,031.53</u>
Total overpayment in each case		\$34,657.35

Plaintiff is therefore entitled to recover on account of the taxes paid for himself and his wife personally, judgment for twice said amount of \$34,657.35, or for \$69,314.70, with interest thereon at the rate of six per cent (6%) per annum from June 9, 1934.

To each of the foregoing findings of fact and conclusions of law, to the extent that they are contrary to the findings of fact and conclusions of law requested by the defendant, the defendant duly excepted in open court.

The defendant having heretofore filed and presented within the time allowed by the Court his motion for findings of fact and conclusions of law, it is ordered that said motion be and it is hereby denied except to the extent that defendant's requested findings of fact and conclusions of law are included hereinabove, to which ruling of the Court defendant duly excepted in open court.

Defendant having heretofore filed and presented within the time allowed by the Court his motion for judgment, it [fol. 201] is ordered that said motion be and it is hereby denied, to which action of the Court defendant duly excepted in open court.

Signed this 29th day of April, 1938.

Robert J. McMillan, United States District Judge.

Approved as to form: W. E. Davant, Homer L. Bruce, Attorneys for plaintiff; W. R. Smith, Jr., United States Attorney; Lester L. Gibson, Special Assistant to the Attorney General, Attorneys for Defendant.

[File endorsement omitted.]

[fol. 202] IN UNITED STATES DISTRICT COURT

No. 1412, Law

[Title omitted]

MOTION FOR JUDGMENT—Filed July 5, 1937

Now comes the defendant, Frank Scofield, Collector of Internal Revenue, at the close of the proof and before the Court has decided or announced its decision herein, and before the final entry of judgment herein, and moves the Court to enter judgment in his favor and against the plaintiff, V. L. LeTulle, for the reason that the evidence is insufficient, as a matter of law, to warrant the entry of judgment for plaintiff, and will not support any other conclusion than that the defendant, as a matter of law, is entitled to judgment, together with all of his costs and disbursements herein.

Respectfully submitted, W. R. Smith, United States Attorney; H. W. Moursund, Assistant United States Attorney; Lester L. Gibson, Special Assistant to the Attorney General, Attorneys for defendant.

—[fol. 203] [Reporter's Certificate to Foregoing Transcript Omitted in Printing]

AGREEMENT OF COUNSEL AS TO BILL OF EXCEPTIONS

We, the undersigned attorneys of record in said cause, hereby agree that the foregoing is a full, true and correct statement of evidence and bill of exceptions in the case of V. L. LeTulle vs. Frank Scofield, United States Collector of Internal Revenue for the First District of Texas, Consolidated No. 1412 Law, United States District Court in [fol. 204] and for the Western District of Texas, Austin Division thereof; and here approve same as the statement of evidence and bill of exceptions in said cause.

Witness our hands this the 15th day of September, in the year of our Lord 1938.

W. E. Davant, Homer L. Bruce, Attorneys for Plaintiff. W. R. Smith, Jr., United States Attorney; H. W. Moursund, Assistant United States Attorney, Lester L. Gibson, Special Assistant to the Attorney General, Attorneys for Defendant.

APPROVAL OF COURT

The foregoing on pages numbered 1 to 170, having been approved by counsel of record for the respective parties, and having been examined and found correct, is hereby approved as the statement of evidence and bill of exceptions in the case of V. L. LeTulle vs. Frank Seofield, United States Collector of Internal Revenue for the First District of Texas, Consolidated No. 1412 Law, United States District Court in and for the Western District of Texas, at the Austin Division thereof; and is hereby ordered filed as a part of the record in said cause.

Witness my hand at San Antonio, Texas, this the 23rd day of September A. D., 1938.

Robert J. McMillan, United States District Judge.

[File endorsement omitted.]

[fol. 205] IN UNITED STATES DISTRICT COURT

DEFENDANT'S MOTION FOR NEW TRIAL—Filed May 2, 1938

Now comes the defendant in the above-entitled and numbered cause and moves the court to set aside the judgment entered in this cause on April 29, 1938, and grant him a new trial, and for grounds respectfully represents:

I

The court erred in overruling defendant's motion for continuance filed in this cause on July 5, 1937.

II

The court erred in overruling defendant's motion for findings of fact and conclusions of law insofar as said requested findings of fact and conclusions of law are not included in the court's findings of fact and conclusions of law filed in this cause on April 29, 1938.

III

The court erred in denying defendant's motion for judgment in this cause because the evidence as a matter of law will only support the conclusion that defendant was entitled to judgment.

IV

The court erred in granting the plaintiff's motion for findings of fact and conclusions of law other than those which he denied, as is shown by the court's findings of fact and conclusions of law filed herein, because there was no substantial evidence to support said findings of fact and conclusions of law.

[fol. 206]

V

The court erred in granting plaintiff's motion for judgment because there was no substantial evidence of probative force authorizing the granting of said motion and was insufficient as a matter of law to support a judgment in favor of plaintiff.

VI

The court erred in making and filing in this cause his findings of fact and conclusions of law to the extent that they are contrary to the findings of fact and conclusions of law requested by the defendant because there is no substantial evidence to support said findings of fact and conclusions of law so entered, with the exception of those which are not contrary to the findings of fact and conclusions of law requested by the defendant.

VII

The court erred in entering judgment in this cause for the plaintiff because there is no substantial evidence to support the same and it is contrary to the law and the evidence.

VIII

In said motion for continuance filed on July 5, 1937, it was alleged that defendant had discovered certain new and additional evidence and asked the court that subpoenas be issued for the attendance of certain witnesses. These subpoenas were issued, but prior to the service thereof, the court entered an order quashing the same and the defendant was, therefore, deprived of the right to have witnesses present to testify concerning the matters set out in the said motion for continuance filed on July 5, 1937.

[fol. 207] The defendant, through his agents and the office of the Bureau of Internal Revenue, made certain investigations which the defendant believes, if given an opportunity to

prove, will show that the said alleged contract of November 5, 1931, under which V. L. LeTulle is supposed to have sold the assets of the Gulf Coast Irrigation Company to the Gulf Coast Water Company, was not in truth, and in fact the contract under which this sale was had, but on the contrary, if given an opportunity to prove, the defendant states that he will show that V. L. LeTulle entered into a binding contract on November 5, 1930, between himself and the Gulf Coast Irrigation Company as parties of the first part, and B. E. Buckman and Company as party of the second part, whereby he bound himself to sell to said R. E. Buckman all the assets of the said Gulf Coast Irrigation Company; that this contract was never abrogated, but that shortly after entering into the same, he received a payment of \$25,000 on the said contract, which was later applied to the purchase price thereof. A copy of this contract, as taken from the files of B. E. Buckman and Company of Madison, Wisconsin, is attached hereto as Exhibit A. of this motion and made a part hereof.

A supplemental contract dated January 22, 1931, between V. L. LeTulle and Gulf Coast Irrigation Company and B. E. Buckman and Company, is attached hereto as Exhibit B and made a part hereof. An unsigned copy of an agreement and supplemental contract dated August 3, 1931, between V. L. LeTulle and Gulf Coast Irrigation Company and B. E. Buckman and Company is attached hereto as Exhibit C. An agreement dated June 30, 1932, between V. L. LeTulle and Gulf Coast Water Company, is attached hereto as Exhibit D. Agreement dated December 22, 1932, between V. L. LeTulle and Gulf Coast Water Company, is attached hereto as Exhibit E. All of these instruments [fol. 208] were taken from the files of B. E. Buckman and Company of Madison, Wisconsin.

Upon investigation by an Agent of the Bureau of Internal Revenue and examination of the files of the Continental Public Service Company, the following documents, a copy of each of which is attached hereto as Exhibits 1 to 14, inclusive, were obtained:

Said Exhibit 1, dated December 16, 1930, is an offer by E. J. Crofoot to sell a contract of purchase for the water system in the counties of Wharton and Matagorda between V. L. LeTulle and others, dated November 5, 1930, whereby it was offered to sell the said contract with V. L. LeTulle

and others for certain considerations, and which was accepted on December 16, 1930, by the Vice President of the Continental Public Service Company.

Said Exhibit 2 shows a copy from the Minute Book of the Continental Public Service Company authorizing and directing acceptance on the part of the corporation of said proposal to sell the contract entered into between V. L. LeTulle and B. E. Buckman and Company.

Said Exhibit 3 shows a copy of the Minutes of Special Meeting of Directors of Central West Water and Power Company and is a resolution authorizing the purchase by the Central West Water and Power Company of the contract with V. L. LeTulle, et al., dated November 5, 1930, covering said water system by assuming the contract obligation of \$800,900.00 and by executing demand note for \$500,062.50 with six per cent interest.

Said Exhibit 4, Central West Water and Power Company, Minutes of Special Meeting of Stockholders, held in the office of the company at Madison, Wisconsin, September 14, 1931, relative to the sale of the Gulf Coast Irrigation Company by V. L. LeTulle, wherein the President stated [fol. 209] that after investigation, under the laws of the State of Texas, it would be necessary for the purchaser of said Gulf Coast Irrigation Company to be a Texas corporation and he called attention to the fact that the property to be acquired by V. L. LeTulle now owned by said company was all situated in the State of Texas and that it would be necessary in order to acquire that property and operate it with all the rights and privileges necessary and incidental a Texas corporation would have to be organized, and that in order to close up the contract with LeTulle and acquire the title subject to mortgage, it would be necessary to have \$25,000.00 to complete payment, and a resolution was offered and unanimously adopted that the Gulf Coast Water Company assume the contract obligation dated November 5, 1930, and execute its demand note to the corporation for \$525,062.50. This meeting was held on September 14, 1931, at which time the Gulf Coast Water Company had not been organized according to the said minutes.

Said Exhibit 5, Minutes of Special Meeting of the Stockholders of the Gulf Coast Water Company, held on the 3rd day of November, 1931. At said meeting the President stated that the Central West Water and Power Company was the present owner and holder of the contract with

V. L. LeTulle, et al., dated November 5, 1930, covering water systems in Wharton and Matagorda Counties, Texas, and that said Central West Water and Power Company offered to transfer said contract and assign same to this corporation upon assuming obligations thereof and executing demand note for \$500,062.50, bearing six per cent interest after demand, and assuming an open account of the Central West Water and Power Company in favor of B. E. Buckman and Company in the sum of \$25,000.00. Upon resolution, moved and seconded, the offer to assume the obligation of said contract and the open account was approved.

[fol. 210] Said Exhibit 6, Minutes of Special Meeting of the Board of Directors of the Gulf Coast Water Company, which approved the action of the stockholders of the said Gulf Coast Water Company in purchasing the V. L. LeTulle contract.

Said Exhibit 7 is an agreement for the holding of a special meeting of the stockholders of the Gulf Coast Water Company which had to do with the approval of the acquisition of the assets and business of the Gulf Coast Irrigation Company, a Texas corporation, in exchange for \$50,000.00 cash and \$750,000.00 in the principal amount of the First Mortgage Six Per Cent Serial Gold Bonds of this corporation.

Said Exhibit 8, copy of the minutes of Special Meeting of Stockholders of the Gulf Coast Water Company, held November 4, 1931, which sets out the plan of purchasing the assets of the Gulf Coast Irrigation Company and V. L. LeTulle.

Said Exhibit 9 is an agreement for the holding of a special meeting of the directors of the Gulf Coast Water Company, dated November 4, 1931, which was to approve and authorize the acquisition of the property and assets of the Gulf Coast Irrigation Company.

Said Exhibit 10 is a copy of the Minutes of Special Meeting of Directors of the Gulf Coast Water Company, dated November 4, 1931, covering the acquisition of the properties of the Gulf Coast Irrigation Company.

Exhibit 11 is a copy of a telegram from V. L. LeTulle to B. E. Buckman and Company, undated, which appears to have been sent along in October, 1931, in which he stated that he was ready to execute deed and close title to the properties.

Exhibit 12 is copy of a letter dated October 19, 1931, from E. J. Crofoot, an officer of the Interstate Public Ser-[fol. 211] vice Company, to B. E. Buckman and Company, advising of the changes made and to be made in the said contract of purchase.

Exhibit 13 is copy of a letter dated November 4, 1931, from E. J. Crofoot to B. E. Buckman and Company, which further discusses the changes and discusses the trust indenture to be given to LeTulle upon the consummation of the contract of November 5, 1930.

Exhibit 14 is copy of a letter dated November 7, 1931, from E. J. Crofoot to B. E. Buckman and Company showing that Messrs. Wharton and Davant, as well as LeTulle, were endeavoring to close the transaction relative to the final transfer of the assets of the Gulf Coast Irrigation Company. All exhibits attached hereto are made a part hereof.

The journal of the Central West Water and Power Company, on page 57-a, recorded by J. E. 273-a, dated January 2, 1931, the acquisition of the water system by the purchase of the contract dated November 5, 1930, hereinbefore mentioned, from the Continental Public Service Company. This entry records the assumption of the \$800,000.00 due Gulf Coast Irrigation Company and the issuance of the \$500,062.50 note payable to Continental Public Service Company.

Journal entry 273-B, dated January 27, 1931, as recorded on the books of the Central West Water and Power Company, records a credit of \$10,000.00 to B. E. Buckman and Company for the payment of that amount on the LeTulle and Gulf Coast Irrigation Company contract, in accordance with the terms of the supplemental contract between V. L. LeTulle, et al., and B. E. Buckman and Company, dated January 22, 1931.

Journal entry 273-C of the Central West Water and Power Company, records a credit of \$15,000.00 to B. E. Buckman and Company for the payment of that amount on [fol. 212] the LeTulle contract in accordance with the terms of the above-mentioned supplemental contract dated January 22, 1931.

Journal entry 487 on the books of Central West Water and Power Company, made in November, 1931, records a credit of \$25,000.00 to B. E. Buckman and Company for the payment of the balance of \$50,000.00 to be paid in cash to V. L. LeTulle in accordance with the contract.

It is, therefore, obvious and apparent from these records that these various corporations, as well as the plaintiff in this case, were acting upon the contract of sale entered into between Gulf Coast Irrigation Company and V. L. LeTulle and B. E. Buckman and Company dated November 5, 1930. The entire cash payment of \$50,000.00 was paid on said contract on or prior to the date of the contract of November 4, 1931. It is believed that this evidence shows that in reality there was an outright sale of the assets of the Gulf Coast Irrigation Company rather than a reorganization as it is called by plaintiff, and that the contract dated November 4, 1931, was entered into between the parties merely for the purpose of calling the transaction a reorganization for the sole and exclusive purpose of attempting to evade taxes. It is believed that if defendant had had an opportunity to offer this evidence, that the decision of the court on the reorganization question would have been different and that the court would have held that the transaction between the Gulf Coast Irrigation Company and V. L. LeTulle and the various corporations herein mentioned, as well as the Gulf Coast Water Company, which, according to the records, was created for the sole purpose of taking over the contract for the sale of the properties which had been acquired by the Central West Water and Power Company through transfer originally from B. E. Buckman and Company to Continental Public Service Company, was an [fol. 213] outright sale under the provisions of the contract dated November 5, 1930, instead of a reorganization as alleged by plaintiff.

The court, therefore, erred in not granting the defendant's motion for continuance in order to give him an opportunity to make the proof as to what actually transpired between the plaintiff and the various corporations in order that the true facts in connection therewith might be known.

Defendant is further entitled to a new trial because of the newly discovered evidence having a direct bearing on the case, which has been pointed out to the court hereinbefore.

Wherefore, defendant prays that the judgment in this cause be set aside and that defendant be granted a new trial.

W. R. Smith, Jr., United States Attorney. Lester L. Gibson, Special Assistant to the Attorney General; Attorneys for Defendant.

EXHIBIT A

In the District Court of the United States for the Western
District of Texas

No. 1412 Law

[Title omitted]

I, T. A. Hoeveler, being first duly sworn on oath, certify and state that the attached photostatic copy of a contract dated November 5, 1930, between V. L. LeTulle and Gulf Coast Irrigation Company, domiciled in Matagorda County, Texas, parties of the first part, and B. E. Buckman & Com-[fol. 214] pany, a Wisconsin corporation domiciled at Madison, Wisconsin, party of the second part, is a true and correct photostatic copy of such original contract, and all thereof; that said original contract was taken from the files of the said B. E. Buckman & Company, by B. E. Buckman, president of said company, and by him delivered to affiant for the purpose of having such original contract photostated.

I further certify that I am an internal revenue agent whose post of duty is at Madison, Wisconsin, and as such directed by the Commissioner of Internal Revenue of the United States, through the Internal Revenue Agent in Charge at Milwaukee, Wisconsin to obtain such photostatic copy.

T. A. Hoeveler.

Subscribed and sworn to before me this 17th day of August, 1937. H. C. Hale, Clerk United States District Court, Western District of Wisconsin.
(Seal.)

In the District Court of the United States for the Western
District of Texas

No. 1413 Law

[Title omitted]

I, T. A. Hoeveler, being first duly sworn on oath, certify and state that the attached photostatic copy of a contract dated November 5, 1930, between V. L. LeTulle and Gulf Coast Irrigation Company, domiciled in Matagorda County, Texas, parties of the first part, and B. E. Buckman & Com-

pany, a Wisconsin corporation domiciled at Madison, Wisconsin, party of the second part, is a true and correct photostatic copy of such original contract, and all thereof; that said original contract was taken from the files of the said B. E. Buckman & Company by B. E. Buckman, president of said company, and by him delivered to affiant for the purpose of having such original contract photostated.

I further certify that I am an internal revenue agent whose post of duty is at Madison, Wisconsin, and as such directed by the Commissioner of Internal Revenue of the United States, through the Internal Revenue Agent in Charge at Milwaukee, Wisconsin to obtain such photostatic copy.

T. A. Hoeveler.

Subscribed and sworn to before me this 17th day of August, 1937. H. C. Hale, Clerk United States District Court Western District of Wisconsin. (Seal.)

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE
WESTERN DISTRICT OF TEXAS

No. 1412 Law

[Title omitted]

I, B. E. Buckman, president of B. E. Buckman & Company, a Wisconsin corporation domiciled at Madison, Wisconsin, do hereby certify on oath that I delivered the original contract dated November 5, 1930, wherein V. L. Letulle and Gulf Coast Irrigation Company, domiciled in Matagorda County, Texas, are parties of the first part, and B. E. Buckman & Company, domiciled at Madison, Wisconsin, is party of the second part, to T. A. Hoeveler, for the purpose of having said contract photostated; that I have [fol. 216] compared the attached photostatic copy of said contract with the original contract and that the same is a true and correct photostatic copy of said contract, and all thereof; that said contract was taken by me from the files of said B. E. Buckman & Company, of which I am president.

B. E. Buckman.

Subscribed and sworn to before me this 17th day of August, 1937. E. C. Hoff, Jr. My Commission Expires September 5, 1937. (Seal.)

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE
WESTERN DISTRICT OF TEXAS

No. 1413 Law

[Title omitted]

I, B. E. Buckman, president of B. E. Buckman & Company, a Wisconsin corporation domiciled at Madison, Wisconsin, do hereby certify on oath that I delivered the original contract dated November 5, 1930, wherein V. L. LeTulle and Gulf Coast Irrigation Company, domiciled in Matagorda County, Texas, are parties of the first part, and B. E. Buckman & Company, domiciled at Madison, Wisconsin, is party of the second part; to T. A. Hoeveler, for the purpose of having said contract photostated; that I have compared the attached photostatic copy of said contract with the original contract and that the same is a true and correct photostatic copy of said contract, and all thereof; that said contract was taken by me from the files of said B. E. Buckman & Company, of which I am president.

B. E. Buckman.

[fol. 217] Subscribed and sworn to before me this 17th day of August, 1937. E. C. Hoff, Jr. My Commission Expires September 5, 1937. (Seal.)

THE STATE OF TEXAS,
County of Matagorda.

This contract this day made and entered into by and between V. L. LeTulle of Matagorda County, Texas and Gulf Coast Irrigation Company, a Texas corporation, domiciled in Bay City, Matagorda County, Texas, hereinafter called party of the first part and B. E. Buckman and Company, a Wisconsin corporation, domiciled at Madison, in the State of Wisconsin, hereinafter called party of the second part, Witnesseth:

That the party of the first part has this day bargained and sold, and by these presents does hereby bargain, sell and obligate themselves to convey and/or cause to be conveyed in the manner hereinafter stated unto the said party of the second part the following described property to-wit:

All of the pumping plants, intakes, pumps, machinery, canals, flumes, laterals, leads, ditches, rights-of-way of

canals and laterals and water rights, personal property now owned by Gulf Coast Irrigation Company and water contracts made or to be made by Gulf Coast Irrigation Company with it's water tenants for the year 1931 including it's contract with Texas Gulf Sulphur Company, together with all earnings under such contracts from and after the date of January 1st, A. D. 1931.

2. The consideration for this contract is the representation made by party of the first part as follows:

(a) That the properties owned by Gulf Coast Irrigation Company consist of the canals and canal rights-of-way and water rights, formerly belonging to Markham [Vol. 218] Irrigation Company, Texas Irrigation Company, Moore-Cortes Canal Company, Collegeport Canal Company, Lane City Canal Company, Bay City Canal Company, Matagorda Canal Company, Colorado Canal Company, Security Canal Company, Gravity Canal Company, Peyton Creek Irrigation District, Gulf Coast Irrigation Company, and a portion of the Northern Irrigation Company.

(b) That the gross income derived from its water tenants during the year 1930 (the fiscal year ending April 1st, 1931) is in excess of \$282,000.00, after fixing a water rental against the lands of V. L. LeTulle irrigated for said year of \$9.00 per acre.

(c) That the net income for said period taking into account the water rental of \$9.00 per acre against the lands irrigated for the said V. L. LeTulle, will exceed \$140,000.00, and

(d) That V. L. LeTulle owns all of the stock of Gulf Coast Irrigation Company with the exception of qualifying shares, and

The further consideration of \$10.00 cash to him in hand paid and that no representations have been made or relied upon other than those herein set out, and the further consideration hereafter to be paid as hereinafter provided.

3. The party of the second part will have it's engineers to begin appraising the properties hereinbefore described at a date not later than the 15th day of November, 1930, and that such engineers will continue their work in the field until same is completed, with due diligence and without interruption, and will, within twenty days after the comple-

tion of said work on the ground, make a report showing the result of said appraisalment.

That within five days after the engineers have completed their field work the party of the second part will have [fol. 219] it's auditors to begin making an audit to determine whether or not the representations as to earnings are accurate and correctly represented, which said auditors shall continue their work to completion and make their report of approval or disapproval within ten (10) days from the completion of their work, in no event to be later than the 15th day of January, A. D. 1931.

4. Upon the completion of the engineer's and auditor's reports if such reports should disclose that party of the first part has pumping plants, canals and facilities, water rights and water supply sufficient to water thirty thousand acres of land and that the representation hereinbefore set out made by party of the first part are true, and are approved by party of the second part, then party of the second part agrees to pay the sum of \$800,000.00 as hereinafter provided. In the event that said reports are adverse, or are not approved by party of the second part, party of the second part shall immediately decline to proceed with this sale and this contract shall thereupon become null and void without obligation, penalty or damage to either of the parties hereto.

5. It is further agreed that this contract shall not be recorded by either of the parties hereto until after the auditor's and engineer's reports have been made as herein provided, and shall not then be recorded should second party fail to complete the purchasing of said properties.

Should the engineer's and auditor's reports show that the representations of the party of the first part are true, and same are approved by second party, then party of the second part agrees to pay to party of the first part the sum of \$800,000.00, plus the actual cost and expense incurred by said party of the first part in the operation and maintenance of said Gulf Coast Irrigation Company, from and [fol. 220] after the 1st day of January, 1931, which said purchase price is to be paid as follows:

On or before January 22nd, 1931, Twenty-five thousand dollars (\$25,000.00) in cash shall be paid to V. L. LeTulle at The First National Bank of Bay City, Texas, by the

party of the second part, with the express agreement and understanding that if said party of the first part does in fact make and tender to said party of the second part, a general warranty deed conveying to said second party the property hereinbefore described for the price and subject to the terms hereinbefore stated, and does in fact deliver to said vendee abstracts showing merchantable title to said property and the said vendee thereupon fails or refuses to keep and perform the obligations upon it imposed by this agreement, then and in that event it shall forfeit to the said party of the first part the \$25,000.00 as liquidated damages.

6. Upon the payment to party of the first part of the sum of \$25,000.00, party of the first part will within ninety (90) days from the date of said payment, produce and deliver to party of the second part complete abstracts showing merchantable title to the property herein described. Party of the second part shall thereupon have sixty (60) days from the delivery of said abstract, within which to examine the same, and point out objections, if any, and such objections shall be cured within a reasonable time by party of the first part. Should party of the first part fail or refuse to cure such objections, party of the second part shall have the right to cure the same within a reasonable time, if cured, at the expense of the first party, or to waive such objections.

7. In the event that such objections cannot be cured within a reasonable time, then this contract shall terminate and be of no further force and effect, and party of the [fol. 221] second part shall be entitled to a return of the \$25,000.00, theretofore paid and neither of the parties hereto shall be entitled to make any claim for expense or damage growing out of this contract.

8. Should examination of said abstracts disclose merchantable title in and to said properties in party of the first part, that the said party of the first part will deliver to party of the second part warranty deed to said property, reserving a vendor's lien in said deed to secure the payment of the deferred portion of the purchase price represented by vendor's lien notes, and party of the second part will pay to party of the first part the sum of \$175,000.00 in addition to the \$25,000.00 theretofore paid, making a cash payment

of \$200,000.00; will pay in cash all costs of operations and maintenance of said properties from January 1st, 1931 up to the date of said payment and delivery of deed, the first note due one year after date, and one each year thereafter, and will deliver twelve (12) notes of even date with said deed, secured by a first vendor's lien on the properties described in said deed, each of said notes being for the sum of \$50,000.00 principal, bearing interest from date at the rate of six (6%) per cent per annum, interest payable annually, providing for the usual ten (10%) per cent attorney's fee in the event of default, and providing that failure to pay any one of said notes or any installment of interest, shall, at the option of the holder of said notes or any one of them, mature all of said notes.

9. It is further provided that in order to secure payment of said notes according to their tenor and effect, the party of the second part will execute a deed of trust securing the payment of said notes, said deed of trust to be the customary and usual form to C. R. Wharton of Harris County, Texas, Trustee, or to such other trustee as shall be nominated by party of the first part, and said deed of [fol. 222] trust lien shall secure the payment of said notes by the properties herein provided to be conveyed and by a lien upon all additional improvements that are made to said properties until said notes are fully paid.

10. In the event party of the second part shall desire to pay off the \$600,000.00 represented by the twelve (12) notes hereinbefore described, at any time on or before nine (9) months from the date of said notes, it shall have the option to pay off said notes by the payment to V. L. LeTulle, or order, at The First National Bank, Bay City, Texas, of the sum of \$500,000.00 in cash, plus six (6%) per cent interest on said \$500,000.00 from the date of said notes to the date of such payments. In any event, second party shall at all times be entitled to pay off the entire amount of principal and interest then due.

11. It is further provided by, and between the parties hereto that in the event party of the second part should complete the purchase of the properties hereinbefore described, that so long as any part of the purchase price remains unpaid, in that any part thereof is represented by vendor's lien notes, it is specifically agreed that no waste

will be committed by party of the second part or its assigns, and that no radical changes in the form of the security or operation of the property will be made without the consent of the said V. L. LeTulle, or other holder of said notes.

12. It is further distinctly understood that the sale of these properties shall be made as a unit, and that said properties shall be accepted and purchased as a whole or shall be rejected in the entirety.

13. It is further distinctly understood that this contract shall be wholly performable in the County of Matagorda, in the State of Texas.

[fol. 223] 14. Party of the First part shall be deemed to have title to property within the purview of this contract whether the same shall be held by a warranty deed by said party of the First part or by perpetual easement.

15. Party of the First part further agrees that neither Gulf Coast Irrigation Company nor the said V. L. LeTulle will engage directly or indirectly in the irrigation business in Wharton or Matagorda County, Texas, for a period of thirty (30) years from and after the date of the execution of the deed of conveyance herein provided for, unless the said party of the first part shall repurchase the properties herein conveyed, or otherwise come into possession of said property, or a part thereof.

16. That from and after January 1st, 1931, and up to and including the date of delivery of instruments of transfer heretofore provided for, first parties agree that the business of the Gulf Coast Irrigation Company will be carried on in the regular, ordinary, and usual manner as heretofore, that the salaries of employees and officers will not be increased, that no bonuses will be paid to officers or directors, that no dividends, whether stock or cash, will be declared to stockholders, that the Gulf Coast Irrigation Company will have maintained its status as a corporation legally entitled to do business in the State of Texas, and that all franchise taxes and governmental charges levied or assessed against said corporation prior to January 1st, 1931, will be promptly paid and discharged, second party to have right of examination of corporate records.

That all income taxes of Gulf Coast Irrigation Company arising prior to January 1st, 1931, will be promptly paid

when due, unless contested in good faith, and in such case payment will be made on final determination, and party of the first part will hold party of the second part harmless from any liability therefrom.

[fol. 224] All taxes for the year 1931 and thereafter are to be paid by party of the second part.

17. It is further understood that all seed rice, money on hand, accounts receivable and unliquidated claims and demands arising prior to January 1st, 1931, are to be retained by party of the first part.

18. That from and after the date hereof no major improvement or radical change in the form of operation of the property hereby sold, will be made without the consent of second party.

19. All of the covenants, agreements, representations and conditions of these presents shall be binding upon the parties hereto and their respective heirs, successors, administrators and assigns.

In Witness Whereof, V. L. LeTulle, one of the parties of the first part, has hereto set his hand and seal, and the Gulf Coast Irrigation Company and B. E. Buckman and Company have caused these presents to be executed in the respective corporations names by their respective Presidents and their respective corporate seals to be fixed on the day and year first above written.

November 5th, 1930.

V. L. LeTulle (Seal), Gulf Coast Irrigation Company,
by V. L. LeTulle, President, Parties of the First
Part. B. E. Buckman and Company, by B. E.
Buckman, President, Parties of the Second Part.

In the presence of George W. Stephens, W. E. Davant.

[fol. 225]

EXHIBIT B

THE STATE OF TEXAS,
County of Matagorda:

This supplemental contract made and entered into this the 22nd day of January, A. D. 1931, by and between V. L. LeTulle of Matagorda County, Texas, and Gulf Coast Irrigation Company, a Texas corporation, domiciled in Bay City, Matagorda County, Texas, hereinafter called parties

of the first part and B. E. Buckman & Company, a Wisconsin Corporation, domiciled at Madison, Dane County, Wisconsin, hereinafter called party of the second part; Witnesseth:

(a) For the purpose of clarifying the contract of November 5th, 1930, by and between the parties hereto and for the further purpose of amplifying said contract it is agreed by and between the parties hereto as follows, to-wit:

1. That the property proposed to be conveyed, and as described in paragraph No. Two, Section A, of said contract of November 5th, 1930, is to be conveyed by warranty deed conveying either fee simple title or easements in perpetuity. In addition thereto, the Buckeye right-of-way (so called) is held under a year to year lease and only such rights as are in said lease contained are to be conveyed under said contract. That in addition to the property described in said contract there is approximately Three hundred Twenty-five (325) acres, more or less, of Peyton Creek lands situated on Lake Austin (belonging to said Gulf Coast Irrigation Company or V. L. LeTulle), and Twenty-eight (28) acres of land, more or less, in the Thomas Cayce Survey on the West bank of the Colorado River, which said tract is composed of a nine (9) acre parcel and a nineteen (19) acre parcel, and One hundred and eight (108) acres, more or less, originally belonging to The Colorado Canal Company [fol. 226] and/or Gulf Coast Irrigation Company, all of which said parcels of tracts of land will be conveyed to the party of the second part as part of the properties of the parties of the first part. It being the intention of said contract of November 5th, 1930, and of this supplemental contract to provide for a conveyance of all the real property owned by the Gulf Coast Irrigation Company, either in fee simple or under perpetual easements or leases on January 1st, 1931, excepting however, that the Fourteen Hundred and Seventy-six (1476) acre tract known as the Olcese tract, the Two Hundred (200) acre tract known as the Texas Pumping Plant and the Seventy (70) acre tract known as the Ashby tract shall not pass or be conveyed as part of the Gulf Coast Irrigation Company properties, whether the same shall stand in the name of said Company on January 1st, 1931, or not.

2. That the terms of payment in said contract of November 5th, 1930, are so modified so that the Twenty-five Thou-

sand (\$25,000.00) Dollar sum, payable on or before January 22nd, 1931, is to be paid as follows:

Ten Thousand Dollars (\$10,000.00) shall be paid concurrently with the execution of this supplemental contract and Fifteen Thousand Dollars (\$15,000.00) on or before February 10th, 1931;

that the payment in cash for the costs of operation and maintenance of the Gulf Coast Irrigation Company properties to be made by party of the second part shall be made on or before November 1st, 1931, and all rentals and income from said Gulf Coast Irrigation Company shall apply towards this said payment.

3. That paragraph fifteen (15) of said contract of November 5th, 1930, shall by its terms exclude the operation of an irrigation plant or system for the purpose of supply [fol. 227] ing the lands or tenants of V. L. LeTulle and shall further exclude the operation of a water system in any capacity by said V. L. LeTulle.

4. Except as herein and hereby amplified, clarified or amended said contract of November 5th, 1930, shall remain in full force and effect.

In Witness Whereof, V. L. LeTulle, one of the parties of the first part has hereto set his hand and the Gulf Coast Irrigation Company and B. E. Buckman & Company, have caused these presents to be executed in quadruplicate original in their corporate names by their proper officers, and their respective corporate seals to be hereunto affixed on the day and year first above written.

V. L. LeTulle, Gulf Coast Irrigation Co. By V. L. Letulle Pres. /S/, B. E. Buckman & Co., By B. E. Buckman, Pres. /S/.

Attest:

Louis LeTulle, Secy. /S/

Attest:

E. C. Holt, Jr., Sec. /S/.

I, Theodore A. Hoeveler, Internal Revenue Agent, hereby certify that the above is a true and correct copy.

Theodore A. Hoeveler, Internal Revenue Agent.

July 26, 1937.

EXHIBIT C

THE STATE OF TEXAS,
County of Matagorda.

This Agreement and Supplemental Contract made and entered into this the 3rd day of August, A. D. 1931, by and between V. L. LeTulle of Matagorda County, Texas, and [fol. 228] Gulf Coast Irrigation Company, a Texas Corporation, domiciled in Bay City, Matagorda County, Texas, hereinafter called parties of the first part and B. E. Buckman & Company, a Wisconsin Corporation, domiciled at Madison, Dane County, Wisconsin, hereinafter called party of the second part, Witnesseth:

Supplementing the Contract of November 5, 1930, and the supplement thereto dated January 22nd, 1931, by and between these parties, it is agreed as follows:

That the parties of the first part will complete the curing of defects in the title to the properties described in the contracts above referred to and that party of the second part will, as rapidly as possible, pass upon all curative matters submitted.

That in the event attorneys for party of the second part approve the title offered by party of the first part as being a merchantable title, or that second party shall accept the title to said properties offered by parties of the first part, then party of the second part agrees to pay interest on that portion of the purchase price of said properties to be represented by vendor's lien notes, to-wit, the sum of Six Hundred Thousand Dollars, at the rate of six percent per annum from the date of this supplemental agreement to the date of the execution of the deed and vendor's lien notes provided in said original contract, this interest to be payable in cash on the date of the delivery of said deed and notes. The deed and notes shall bear date as of their actual execution.

Except as herein and hereby amplified, the said contract of November 5, 1930, and the supplemental—thereto of January 22nd, 1931, shall in all respects remain in full force and effect.

[fol. 229] In witness whereof, V. L. LeTulle, one of the parties of the first part has hereto set his hand and the Gulf Coast Irrigation Company and B. E. Buckman & Company, have caused these presents to be executed in quadruplicate

original in their corporate names by their proper officers, and their respective corporate seals to be hereunto affixed on the day and year first above written.

Gulf Coast Irrigation Company, by — — —, President.

Attest: — — —.

B. E. Buckman & Company, by — — —, President.

Attest: — — —.

I, Theodore A. Hoeveler, Internal Revenue Agent, hereby certify that the above is a true and correct copy.

Theodore A. Hoeveler, Internal Revenue Agent.

Dated: July 26, 1937.

EXHIBIT D

AGREEMENT DATED JUNE 20, 1932

THE STATE OF TEXAS,
County of Matagorda.

This Agreement, this day made and entered into by and between V. L. LeTulle, of the County of Matagorda, and State of Texas, and Gulf Coast Water Company, a Texas corporation, domiciled at Bay City, Matagorda County, Texas, Witnesseth:

That whereas, on the 19th day of November, A. D. 1931, Gulf Coast Water Company executed a certain Deed of [fol. 230] Trust to J. C. Lewis, Trustee, to secure the payment of Seven Hundred Fifty and no/100 Thousand (\$750,000.00) Dollars, of bonds payable to V. L. LeTulle, bonds numbered 1 to 15 inclusive being for the denomination of \$10,000.00 each, and maturing January 1st, 1933, and bonds numbered 16 to 27 both inclusive, being for the principal sum of \$50,000.00 each, bond numbered 16 maturing January 1st, A. D. 1933, and one of said bonds maturing on the 1st day of January of each year thereafter until all of said bonds have been paid.

Said bonds and the Indenture securing the payment thereof providing that The Bonds issued pursuant to said Indenture are subject to redemption prior to maturity at the option of the Company in the following manner if at any time prior to nine months from November 1, 1931, to-wit, on or before August 1st, 1932, the Company shall elect in writing so to do it may redeem Bonds numbers 16 to 27,

both inclusive, by the payment of five-sixths of the principal amount of each of said Bonds, to-wit, the sum of Forty One Thousand Six Hundred Sixty Six and 67/100 Dollars (\$41,666.67) plus accrued interest to the date fixed for redemption at the rate and in the manner provided in said Indenture.

And whereas, the said V. L. LeTulle, is the owner and holder of said Bonds numbered 16 to 27 both inclusive, and Gulf Coast Water Company has elected to not pay Bonds numbered 16 to 27 inclusive on or before the 1st day of August A. D. 1932, and has requested that Bond numbered 16 shall be extended so that the Maturity date thereof shall be the 1st day of April A. D. 1933.

Now, Therefore, Know all Men by These Presents:

1. That Gulf Coast Water Company has and does by the execution of this instrument, renounce its right to pay [fol. 231] off and discount Bonds 16 to 27, inclusive, on or before August 1, A. D. 1932.

2. That Gulf Coast Water Company will pay to the said V. L. LeTulle on the 31st day on December, A. D. 1932, the interest on bonds numbered 16 to 27, inclusive, maturing on January 1st, A. D. 1933, in the event the said V. L. LeTulle shall elect to receive such interest on December 31st, A. D. 1932, instead of January 1st, A. D. 1933.

In consideration of the premises and of the payment to the said V. L. LeTulle on December 31st, A. D. 1932, at his election of the interest due upon bonds numbered 16 to 27 inclusive, due January 1st, A. D. 1933, the said V. L. LeTulle has agreed, and does hereby agree, that Bond numbered 16 of the Gulf Coast Water Company hereinbefore described maturing January 1st, A. D. 1933, shall be extended so that the same shall mature and become due and payable on the 1st day of April, A. D. 1933.

Gulf Coast Water Company does further agree that it will pay interest at the rate of 6% per annum upon said Bond numbered 16 from the 1st day of January, A. D. 1933, until the same is fully paid, principal and interest.

Executed in duplicate originals at Bay City, Texas, this the 20th day of June A. D. 1932.

(Signed) Gulf Coast Water Company, by E. J. Crofoot, Its President.

Attest:

M. L. Long, Ass't Secretary, V. L. LeTulle.

I, Theodore A. Hoeveler, Internal Revenue Agent, hereby certify that the above is a true and correct copy.

(S.) Theodore A. Hoeveler, Internal Revenue Agent.

[fol. 232]

EXHIBIT E.

(Contract of December 22, 1932)

THE STATE OF TEXAS,
County of Matagorda.

This Agreement, this day made and entered into by and between V. L. LeTulle, of the County of Matagorda, and State of Texas, and Gulf Coast Water Company, a Texas corporation, domiciled at Bay City, Matagorda County, Texas, Witnesseth:

That, Whereas, on the 19th day of November, A. D. 1931, Gulf Coast Water Company executed a certain Deed of Trust to J. C. Lewis, Trustee, to secure the payment of Seven Hundred and Fifty Thousand Dollars (\$750,000.00) of bonds payable to V. L. LeTulle, bonds numbered 1 to 15 inclusive, being for the denomination of \$10,000.00 each, and maturing January 1st, 1933, and bonds numbered 16 to 27, both inclusive, being for the principal sum of \$50,000.00 each, bond numbered 16 maturing January 1st, A. D. 1933, and one of said bonds maturing on the 1st day of January of each year thereafter until all of said bonds have been paid.

And, Whereas, bond 15 and a part of bond 14, together with the interest thereon, have not been paid and will mature and become due and payable on January 1st, 1933, and bond numbered 16 for the principal sum of \$50,000.00, together with the interest on bonds numbered 16 to 27, both inclusive, aggregating \$48,000.00, will mature and become payable on January 1st, 1933, unless the Gulf Coast Water Company shall pay to the said V. L. LeTulle on the 31st day of December, 1932, the interest on bonds numbered 16 to 27, inclusive, and shall pay off the remainder due on bond numbered 14 and bond numbered 15, together with the interest thereon, on January 1st, 1933, in which event the [fol. 233] \$50,000.00 principal of bond numbered 16 would become due and payable, together with the interest thereon on the 1st day of April, A. D. 1933.

And, Whereas, Gulf Coast Water Company has requested the said V. L. LeTulle to grant an extension of time to Gulf Coast Water Company within which to make said payments maturing upon January 1st, A. D. 1933, and/or April 1st, A. D. 1933, and the said V. L. LeTulle, in consideration of the making of such extensions as are hereinafter set out and described, has requested additional surety and security to insure the payment of said amounts, and in order to further secure the said V. L. LeTulle in the payments of the indebtedness due January 1st, 1933, and/or April 1st, 1933, Gulf Coast Water Company has agreed to assign its equity in and to all water rents and revenues for the year 1932:

Now, Therefore, Know All Men by These Presents, that Gulf Coast Water Company has and does by the execution of this instrument agree that all revenues, which have accrued or may hereafter accrue to the Gulf Coast Water Company from water rentals and from the operation of the properties of the Gulf Coast Water Company for the year 1932, including collections that may be made from its water tenants for said year, shall be paid to and deposited in The First National Bank of Bay City in a special trustee account entitled (Gulf Coast Water Company and V. L. LeTulle 1932 Escrow Trust), and be paid out only upon the joint signature of V. L. LeTulle, his agent, executor or administrator and E. J. Crofoot, or the then president of Gulf Coast Water Company. This escrow trust account shall be applied first to the payment of the following operating expenses for the year 1932: The balance due for power furnished by the power companies during said year; the indebtedness due to The First National Bank of Bay City and Bay City Bank and Trust Company, including the in-[fol. 234] debtedness due said banks on guarantees and as surety for the indebtedness of the tenants of said company; and the balance due upon the indebtedness due the Humble Oil & Refining Company. Second, this Escrow Trust account shall next be applied to the interest upon the bonded indebtedness due by Gulf Coast Water Company to the said V. L. LeTulle. Third, this Escrow Trust account shall next be applied to the payment of bond numbered 16 and thereafter to any indebtedness remaining due upon bonds numbered 14 and 15 hereinbefore described. When the interest payment due the said V. L. LeTulle, together with bond numbered 16 and the remainder due on bonds numbered 14 and 15 have been retired pursuant to the provisions of this

paragraph, the Escrow trust account shall be closed and any balance in said account and all revenues thereafter shall belong to the Gulf Coast Water Company to be deposited when and where it designates. This Escrow shall be without cost to the Gulf Coast Water Company and shall not be deducted from the aforementioned revenue. Whenever \$1000.00, or any multiples thereof, shall be available for application to the indebtedness of V. L. LeTulle, such available sums shall be paid forthwith to him or the then owner of said bonds.

It is distinctly understood that the indebtedness secured by this Escrow account due the said V. L. LeTulle, shall bear interest from January 1st, 1933, until paid at the rate of 6% per annum, interest to cease upon such proportionate amount as is paid from the date of payment.

Upon the execution of this contract and when a copy of same shall have been lodged with the First National Bank of Bay City, Texas, and accepted by said bank as to the escrow provision hereof, the bank is hereby authorized and requested to notify all water tenants of the Irrigation Company, the Farmers Storage Company, and any and all mills [fol. 235] and warehouses who may purchase rice from water tenants of the Irrigation Company upon which rental is due of the right and duty of the bank to collect and hold these rentals in said trust capacity. And all payments of these rentals shall thereafterwards be made at said bank until the termination of the escrow agreement, in accordance with the provisions of this contract. When the escrow trust is closed as herein provided for, The First National Bank of Bay City, Texas, shall thereupon so notify all water tenants of the Irrigation Company and any and all mills and warehouses who may purchase rice from water tenants of the Irrigation Company upon which rental is due that its right of collection and holding said rentals in its trust capacity has ceased and determined and that further payment shall be made to the Water Company, or its order.

In addition to the assignment of rents and revenues hereinbefore set out, Gulf Coast Water Company hereby agrees that it will continue to operate the properties known as the Gulf Coast Water Company Canal in a businesslike manner and will pay all operating expenses from and after January 1st, 1933, from sources other than its 1932 income, rents and revenues or the corpus of its properties.

In consideration of the premises the said V. L. LeTulle has agreed and does hereby agree that he will extend the time of maturity and payment of the interest due upon the bonded indebtedness of Gulf Coast Water Company, together with the balance due upon bond numbered 14 and bonds 15 and 16 so as to permit the sale of rices upon which Gulf Coast Water Company has a lien for its water rentals in an orderly manner and without requiring the same to be thrown upon the market and marketed in a wasteful manner or in such a way as to break the market price of rice. That he will accept the payments made through the escrow [fol. 236] fund hereinbefore set up and described and apply the same upon such indebtedness as is therein set out.

It is distinctly understood, however, that such extension shall not in any event be beyond June 1, 1933, and that in the event all of the interest due on January 1, 1933, together with the interest thereon from date at the rate of 6% and the balance due on Bond No. 14 and all of the Bonds Numbered 15 and 16, together with the interest thereon at the rate of 6%, have not been paid on or before June 1, 1933, that the same or any balance thereof shall then be due and payable according to the terms and provisions of the bonds and mortgage aforesaid. And the said LeTulle and the Trustee shall have and may exercise at their discretion all the powers and rights granted them under the deed of trust aforesaid.

It is part of this obligation that the Gulf Coast Water Company shall continue the operation of this property during the period from January 1 to June 1, 1933, and shall continue in possession of the properties if and only if it fulfills its obligation to pay said indebtedness in full on or before June 1, 1933, and a failure to pay all or any part of this extended indebtedness on that date shall ipso facto terminate the Gulf Coast Water Company's right to possess the premises and all the properties described in said deed of trust shall automatically come into the possession of V. L. LeTulle without the necessity of action of entry, re-entry or foreclosure on his part. In addition, however, to this automatic repossession of the premises the said LeTulle shall have all the rights of re-entry and foreclosure stipulated for in the deed of trust if he desires.

It is agreed that the operation of these properties from January 1st to June 1st shall be under the joint management

and control of the Gulf Coast Water Company and V. L. [fol. 237] LeTulle and their possession of the properties for the purposes of this joint operation shall be deemed to be joint.

The Gulf Coast Water Company agrees that during said time it will create no indebtedness, execute no contracts binding on the Company, and in any way affecting these properties without the concurrence of V. L. LeTulle, and if the Gulf Coast Water Company should find itself unable to finance the operations of the Canal system, or should fail or refuse to operate the same during said time from January 1st to June 1st, should fail or refuse to pay the indebtedness provided to be paid from the Escrow Trust fund in accordance with its terms, or should fail or refuse to fulfill its obligation to pay the indebtedness due under this agreement to V. L. LeTulle on or before June 1st, 1933, in full, then the said V. L. LeTulle shall be deemed to be in full and exclusive control and possession of all of the properties of the Gulf Coast Water Company, retaining said exclusive possession, control and management pending the foreclosure of the trust indenture, hereinbefore set out.

Except as herein specifically changed or modified, the trust indenture bearing date November 19, A. D. 1931, Gulf Coast Water Company to J. C. Lewis, trustee, and the indebtedness secured by said deed of trust, together with each and every all and singular its terms and conditions shall remain in full force and effect, and shall govern and control the respective rights and liabilities of the parties hereto.

Executed in duplicate original at Bay City, Texas, the 22 day of December, A. D. 1932.

(Signed) Gulf Coast Water Company, by E. J. Crofoot, Its President.

Attest, (Signed) R. G. Wertz, Secretary, V. L. LeTulle.

[fol. 238] I, Theodore A. Hoeveler, Internal Revenue Agent; hereby certify that the above is a true and correct copy.

Theodore A. Hoeveler, Internal Revenue Agent.

July 26, 1937.

EXHIBIT I

(From Minute Book of Continental Public Service Co.)

December 16, 1930

Offer to Continental Public Service Company.

Gentlemen:

The undersigned owns or controls the disposition of the following securities and property and desires to sell and dispose of and procure a purchaser therefor.

Accordingly, I hereby submit to you the following proposal:

A. I will transfer, assign, convey and set over or cause to be transferred, assigned, conveyed and set over the following:

1. All the property and assets of the water plant, property and system known as Kensett Water Company, including all windmills, tanks, reservoirs, towers, wells, pumping machinery, mains, pipes, piping, hydrants, meters, boilers, engines, tools, apparatus, appliances, machinery, facilities, and other property, real, personal or mixed, belonging to the plant property and system and used or useful in and about the operation of the water plant, property and system operating in and serving the incorporated Town of Kensett, County of White, Arkansas, including the franchise from the Town of Kensett.

2. A contract of purchase for the water system in the Counties of Wharton and Matagorda, in the State of Texas, by and between V. L. LeTulle and others, dated November 5, 1930.

[fol. 239] B. As the purchase price of and as consideration for the conveyance, transfer and delivery to you of the above described property you shall at or prior to the delivery and conveyance of said assignments as herein provided, deliver to me or my nominees the following:

- (a) One Thousand Dollars (\$1,000.00) cash.

- (b) Sixteen thousand (16,000) shares of the common stock of no par value of your corporation.

- (c) Three Hundred Seventy-one Thousand Five Hundred Dollars (\$371,500.00) aggregate principal amount of first

mortgage and collateral six per cent gold bonds, Series A, dated December 1, 1930, of your corporation.

(d) Ten thousand (10,000) shares of the Class A common stock of your corporation, of no par value.

(e) An agreement in writing between your corporation and myself whereby you assume and agree to pay the principal obligations of said contract with said V. L. LeTulle et al. amounting in all to Eight Hundred Thousand Dollars (\$800,000.00).

C. If you accept this offer it is understood and agreed that you will take such corporate action as may be necessary to authorize the issuance of the bonds and stock mentioned in this proposal.

D. If you desire to accept this offer you will kindly do so by signing at the end hereof and returning one counterpart of this offer to me.

Yours truly, (S.) E. J. Crofoot.

Accepted this 16th day of December, 1930.

Continental Public Service Company, By (S.) John M. Rooney, Vice President.

[fol. 240] Upon motion of Mr. Clark, seconded by Mr. Medaris, the following resolution was unanimously adopted:

Resolved: That the proposal to this corporation made by E. J. Crofoot of San Antonio, Texas be and the same is hereby accepted by this corporation; and

Be It Further Resolved: That the proper officers of this corporation be and they are hereby authorized and directed to execute on behalf of this corporation an acceptance of the said proposal; and

Be It Further Resolved: That the proper officers of this corporation be and they are hereby authorized and empowered to do all such acts and things as may be necessary to carry out the obligations of this corporation imposed upon it by the acceptance of the proposal of said E. J. Crofoot.

The President thereupon again took the chair.

The President thereupon presented to the meeting a proposal made to this corporation by Mid-State Public Service Company, a corporation, and after said proposal had been read to the meeting the Secretary of the corporation

was directed to file a copy of the proposal as a part of the minutes of this meeting, a copy of which said proposal is as follows:

(cc EM 7/26/37)

EXHIBIT 2

(From Minute Book of Continental Public Service Co.)

Minutes of adjourned meeting of board of directors of the Continental Public Service Company, held at the office of the company on January 2, 1931, at ten o'clock A. M.

The meeting was called to order by the President, E. J. Crofoot.

[fol. 241] Roll call showed all directors present in person excepting W. H. Holmes.

A contract with the B. E. Buckman and Company for the sale of the balance of the Class A Common Stock and the balance of the first mortgage and collateral six percent gold bonds, series A, was gone over and approved, and the proper officers ordered to execute same and the contract was ordered to be filed with the corporate records after execution.

After a full discussion it was moved, seconded and carried that the contract of purchase for the water system in the Counties of Wharton and Matagorda in the State of Texas, by and between V. L. LeTulle et al., dated November 5, 1930, be sold to the Central West Water and Power Company on the following terms and conditions:

1. The Central West Water and Power Company to assume the \$800,000.00 contract obligation as expressed therein, and to give to this corporation its demand note for \$500,062.50, bearing six percent interest after demand.

There being no further business the meeting thereupon adjourned.

(S.) T. W. Medaris, Secretary.

(cc EM 7/26/37)

EXHIBIT 3

Minutes of Special Meeting of Directors of Central West Water and Power Company

A special meeting of the directors of the Central West Water and Power Company was held at the office of the

company at Madison, Wisconsin, on January 2, 1931, at eight-thirty o'clock A. M.

The meeting was called to order by the President, C. J. Jackson.

[fol. 242] Roll call showed all directors present in person.

The Secretary reported that due notice of the meeting had been made to all directors in accordance with the by-laws.

The question of the purchase of the water system in Wharton and Matagorda Counties, Texas, came up for discussion. After a full discussion it was moved, second and carried that this company purchase the contract with V. L. LeTulle et al. dated November 5, 1930, covering said water system on the following terms:

1. By assuming the contract obligation of \$800,000.00.
 2. By executing the demand note of this company for \$500,062.50, with six percent (6%) interest after demand.
- There being no further business the meeting thereupon adjourned.

(Signed) C. J. Jackson, President, S. M. Cramer, Secretary.

(cc EM 7/26/37)

EXHIBIT 4

Central West Water and Power Company Minutes of Special Meeting of Stockholders

A special meeting of stockholders of Central West Water and Power Company was held at the office of the company in the City of Madison, Wisconsin, on September 14, 1931, at two o'clock P. M.

The president, C. J. Jackson, called the meeting to order. Roll call disclosed all stockholders present in person.

The secretary reported due notice of meeting had been mailed to all stockholders at their last known postoffice address in accordance with the by-laws, a copy of which notice follows:

[fol. 243] "Notice is hereby given that a special meeting of stockholders of Central West Water and Power Company will be held at the office of the company, Beaver Building, Madison, Wisconsin, on September 14, 1931, at two o'clock P. M. at which time there will be transacted such business

as is usually transacted at an annual meeting of stockholders and more particularly to consider the question of ways and means to acquire title to the property purchased under the LeTulle contract, and for the purpose of acting on the resignation of C. J. Jackson as officer and director.

"If you cannot attend in person, send in your proxy.
September 7, 1931.

S. M. Cramer, Secretary."

The call of the special meeting was thereupon read, a copy of which follows:

"To the Secretary of Central West Water and Power Company:

"You are hereby directed to call a special meeting of stockholders of Central West Water and Power Company to be held at the office of the company, Beaver Building, Madison, Wisconsin, September 14, 1931, at 2:00 P. M. to transact such business as may be transacted at an annual meeting and to consider ways and means for acquiring title to the property purchased under the LeTulle contract and to consider my resignation as a director.

September 7, 1931.

C. J. Jackson, President."

The president thereupon stated that he had caused an investigation to be made of the laws of the State of Texas and was advised that in order to be certain that the power [fol. 244] of eminent domain was an inherent one in the corporation desiring to use it it would be necessary for it to be a Texas corporation. He called attention to the fact that the property to be acquired from LeTulle under the contract now owned by this company was all situated in the State of Texas and that it would be necessary in order to acquire that property and operate it with all the rights and privileges necessary and incidental a Texas corporation would have to be organized. He further stated that in order to close up the contract with LeTulle and acquire the title subject to mortgage, it would be necessary to have \$25,000.00 to complete payment. He further reported that both he and the Treasurer had found it extremely difficult to secure this money at the present time but he had a promise of it within forty-five days. He thereupon stated and recommended that this corporation transfer the Eldorado Property to E. J. Crofoot for use in organizing a Texas corporation to be

known as the Gulf Coast Water Company and to be re-deeded to this corporation upon the securing of \$25,000.00 which would be turned over to the Gulf Coast Water Company and by it used to acquire the LeTulle property; that this transfer would be a matter of expediency and pending the receipt of the necessary financing, but owing to the urgency of Mr. LeTulle, it was necessary that immediate steps be taken to acquire title. It was thereupon moved, seconded and carried that the Eldorado property of this company be transferred to Mr. E. J. Crofoot for the purposes above set forth, Mr. Crofoot to acknowledge in writing that the property was turned over to him for the purposes mentioned.

The following resolution was offered, seconded and unanimously adopted:

Resolved, that the directors of this corporation transfer [fol. 245] to the Gulf Coast Water Company, when formed, and upon its demand, the contract for the purchase of water systems in Wharton and Matagorda Counties with V. L. LeTulle dated November 5, 1930, on the following terms:

(1) Said Gulf Coast Water Company shall assume the contract obligation therein expressed, and

(2) Execute its demand note to this corporation for \$525,062.50 with interest at six percent after demand all contingent upon the fact that this corporation owns or controls all of the stock of the Gulf Coast Water Company at the time of the transfer of said contract.

C. J. Jackson thereupon tendered his resignation as director, effective September 15, 1931. Thereupon E. J. Crofoot was elected as director to fill the unexpired term of C. J. Jackson.

There being no further business to come before the meeting the same adjourned.

(S.) S. M. Cramer, Secretary.

(cc EM 7/26/37)

EXHIBIT 5

Minutes of Special Meeting of the Stockholders of the Gulf Coast Water Company

On the 3rd day of November, 1931, a special meeting of the stockholders of the Gulf Coast Water Company was

held in the office of the corporation at Bay City, Texas, at nine o'clock A. M. pursuant to the following waiver of notice signed by all the stockholders:

**Waiver of Notice of Special Meeting of the Stockholders
of the Gulf Coast Water Company**

We, the undersigned, being all of the stockholders of the [fol. 246] Coast Water Company, hereby waive notice of the time, purpose and place of the special meeting of the stockholders of the Gulf Coast Water Company, and agree that same may be held at 9 A. M. on November 3rd, 1931, at the office of the Gulf Coast Water Company in Bay City, Texas, for the transaction of such business as may come before the meeting.

(S.) E. J. Crofoot, K. D. Horton, R. G. Wertz.

The foregoing notice having been read, it was ordered spread on the minutes of the meeting. Thereupon the president, E. J. Crofoot took the chair and stated that the Central West Water and Power Company, pursuant to its plan of organization of this corporation, was ready to turn over to this corporation the sum of \$25,000.00 and receive a deed for the property known as the Eldorado property situated in the County of Schleicher and State of Texas and which was originally turned over to this corporation by E. J. Crofoot in the organization thereof, pursuant to the plan set forth by the Central West Water and Power Company, all of which was explained by the president. After a full discussion motion was duly made, seconded and unanimously carried that the stockholders of this corporation authorize and require the board of directors to pass suitable resolutions approving the transfer of the Eldorado property hereinafter described in these minutes and authorizing and requiring the proper officers of the corporation to execute necessary instruments of transfer upon the receipt of \$25,000.00. Here follows a description of the property:

Lot No. 1 in Block L, together with seventy-five (75) feet off Southeast end of Lots Nos. 3, 4 and 5, in [fol. 247] Block L, save and except a strip five (5) feet wide off the Southwest side of Lot No. 3, said seventy-five feet extending to the center of a partition wall between the water works situated on this portion of these premises and the Eldorado Garage which is situated in the Northwest

part of same, including a one-half interest in said partition wall, all of which property is located in the town of Eldorado, Schleicher County, Texas, together with all buildings and improvements thereon or appertaining thereto, and in particular the water plant with elevated tank and concrete clear wall, the water works distribution system, the water works franchise for the operation of a water utility in the town of Eldorado, and all other property of whatsoever kind and nature, pertaining to the water works system in the town of Eldorado, Schleicher County, Texas.

The president further stated that the Central West Water and Power Company was the present owner and holder of a contract with V. L. LeTulle et al. dated November 5, 1930 and covering water systems in Wharton and Matagorda Counties, Texas, and that said Central West Water and Power Company offered to transfer said contract and assign same to this corporation upon assuming the obligations thereof and executing its demand note for \$500,062.50 bearing six percent (6%) interest after demand, and assuming an open account of the Central West Water and Power Company in favor of B. E. Buckman & Company in the amount of \$25,000.00. It was moved, seconded and carried that the stockholders accept this offer subject to the approval of the directors and recommend that upon proper instruments of transfer it execute its demand note for said [fol. 248] amount and assume the obligations of said contract and open account.

Upon motion the meeting adjourned.

(Signed) R. G. Wertz, Secretary; E. J. Crofoot, Chairman.

(cc EM 7/26/37)

EXHIBIT 6

Minutes of Special Meeting of the Board of Directors of the Gulf Coast Water Company

On November 3, 1931, a special meeting of the Board of Directors of the Gulf Coast Water Company was held at 10 A. M. at the office of the corporation in Bay City, Texas, pursuant to the following Waiver of Notice:

Waiver of Notice

Special Meeting of the Board of Directors of the Gulf Coast Water Company

We, the undersigned, being all of the directors of the Gulf Coast Water Company, hereby waive notice of the time, purpose and place of the special meeting of the Board of Directors of the Gulf Coast Water Company; and agree that same may be held at 10 A. M. on November 3rd, 1931, at the office of the Gulf Coast Water Company in Bay City, Texas, for the transaction of such business as may come before the meeting.

(Signed): E. J. Crofoot, K. D. Horton, R. G. Wertz.

The foregoing notice was read and ordered spread upon the minutes of the corporation. Thereupon the president [fol. 249] of the corporation, E. J. Crofoot, took the chair and stated to the Board that the meeting of the stockholders had just been held, at which time the stockholders had authorized the re-deeding of the Eldorado property to the Central West Water and Power Company on payment of \$25,000.00.

Thereupon on motion duly made, seconded and unanimously carried it was

Resolved, that the action of the stockholders be and the same is hereby ratified, approved and confirmed, and that the proper officers are hereby authorized and required to execute all necessary and needful instruments of conveyance and transfer necessary and proper to effectuate and carry out the intention and purpose of this resolution.

The president thereupon called the attention of the directors to the action of the stockholders recommending and approving the purchase of the LeTulle contract, so-called, and upon motion duly made, seconded and carried, it was

Resolved, that the action of the stockholders in purchasing the LeTulle contract, so-called, be and the same is hereby approved, re-enacted and confirmed and that the proper officers be and they are hereby instructed and authorized to execute the demand note of this company for \$500,062.50 bearing six percent interest after demand in favor of the Central West Water and Power Company and that they are further authorized and empowered to execute proper

instruments assuming the obligations under said contract in accordance with the schedule presented at this meeting and assuming the open account of the Central West Water & Power Company with B. E. Buckman & Company in the amount of \$25,000.00.

[fol. 250] There being no further business, the meeting adjourned.

(Signed): R. G. Wertz, Secretary; E. J. Crofoot, Chairman.

(cc EM-7/26/37)

EXHIBIT 7

Gulf Coast Water Company—Agreement for the Holding of a Special Meeting of Stockholders

The undersigned, the holders of all of the issued and outstanding stock of Gulf Coast Water Company, a Texas corporation, owning and holding, respectively, the number of shares thereof set opposite their names, do hereby agree that a special meeting of the stockholders of said corporation may be held at the office of the corporation, Bay City, Texas, on the 4th day of Nov., 1931, at 9:00 o'clock, A. M., and at said meeting that any and all matters pertaining to the affairs and business of said corporation presented for action may be acted upon, including particularly, without limiting the generality of the foregoing, the approval of the acquisition of the properties, assets and business of Gulf Coast Irrigation Company, a Texas corporation, in exchange for Fifty Thousand Dollars (\$50,000.00) cash and Seven Hundred Fifty Thousand Dollars (\$750,000.00) in principal amount of the First Mortgage Six Per Cent Serial Gold Bonds of this corporation; to approve the creation of a bonded indebtedness of this corporation, and the issuance and negotiation of the First Mortgage Six Per Cent Serial Gold Bonds of this corporation in the principal amount of \$750,000.00, the form of indenture of mortgage and the creation of a lien against said properties to secure the payment of said bonds, and to consider and act upon any and all other matters coming before said meeting.

[fol. 251] In Witness Whereof, we have signed our names this 4 day of Nov., 1931.

Name.	No. of Shares	Witness of Signature
E. J. Crofoot	4997	M. L. Long
Pres. Central West Water & Po. Co.		
E. J. Crofoot	1	M. L. Long
R. G. Wertz	1	M. L. Long
K. D. Horton	1	M. L. Long

(cc. EM 7/26/37).

EXHIBIT 8

Gulf Coast Water Company—Minutes of Special Meeting of Stockholders

Pursuant to the foregoing agreement of the holders of all of the issued and outstanding stock, a special meeting of the stockholders of Gulf Coast Water Company was held at the office of the company, Bay City, Texas, at 9:00 o'clock, A. M., on this the 4 day of Nov., 1931.

Mr. E. J. Crofoot, President of the Company, was chosen and acted as chairman of the meeting. Mr. R. G. Wertz, secretary of the company, was chosen and acted as secretary of the meeting. Upon call of the roll of stockholders it was found that all of the 5,000 shares of the issued and outstanding stock of the company was represented at said meeting as follows:

Name	No. of Shares	How Represented
Central West Water & Power Co.	4997	In Person by E. J. Crofoot, Pres.
E. J. Crofoot	1	In Person
R. G. Wertz	1	In Person
K. D. Horton	1	In Person

[fol. 252] The agreement for the meeting and waiver of notice thereof was presented, approved and ordered filed in the minute book of the company.

The chairman stated that since all of the issued and outstanding stock of the company was represented at the meeting the same was duly organized and ready for transaction of business. Thereupon, the chairman presented for consideration the proposal that this acquire all of proper-

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ties, assets and business of Gulf Coast Irrigation Company, in exchange for Fifty Thousand Dollars (\$50,000.00) cash and Seven Hundred Fifty Thousand Dollars (\$750,000.00) in principal amount of the First Mortgage Six Per Cent Serial Gold Bonds of this company. He stated that such acquisition would be made pursuant to the plan of reorganization of the interests of Gulf Coast Irrigation Company and V. L. LeTulle in and to said properties, assets and business, as evidenced by a contract dated Nov. 4th, 1931, entered into between said parties and this company. He stated further that in order to consummate the exchange it would be necessary for this company to authorize the creation of a bonded indebtedness in the principal amount of \$750,000.00, and to authorize and approve the execution of an indenture of mortgage creating a first lien against the properties to be acquired to secure the payment of said bonds.

Upon motion duly made, seconded and unanimously carried, it was resolved:

Resolved, that the stockholders of this corporation hereby approve, ratify and confirm the plan of reorganization under which the interest of Gulf Coast Irrigation Company in its properties, assets and business will be reorganized by the conveyance and transfer of said properties, assets and business [fol. 253] to this corporation in exchange for Fifty Thousand Dollars (\$50,000.00) in cash and First Mortgage 6% Serial Gold Bonds of this corporation in the principal amount of Seven Hundred Fifty Thousand Dollars (\$750,000.00), and do hereby authorize and empower the Board of Directors and the proper officers of this corporation to do and perform any and all acts or things necessary and proper in order to carry out and consummate said exchange, reorganization and the contract of November 4th, 1931; and

Further Resolved, that the stockholders of this corporation hereby approve the form of Indenture of Mortgage which has been submitted to this meeting, and authorize, consent to and sanction the making and execution by this company of an Indenture of Mortgage in substantially the form submitted, the same to be dated as of September 1, 1931; and

Further Resolved, that the form of Indenture of Mortgage which has been submitted to this meeting be properly marked by the Secretary for identification and filed among the records of this corporation; and

Further Resolved, that the Indenture of Mortgage authorized and dated as of September 1, 1931, may cover all or any part of the property, franchises and assets of this corporation other than property of the character of excepted property as defined in said Indenture, and the officers of this corporation are hereby authorized, empowered and directed, prior to the execution and delivery of said Indenture, to insert therein proper description of the property, franchises and assets of this corporation to be included therein; and

[fol. 254] Further Resolved, that the stockholders of this corporation hereby authorize, consent to, approve, ratify and sanction the creation of a bonded indebtedness of this corporation as set forth and provided for in said Indenture of Mortgage, and the issue and delivery of the First Mortgage 6% Serial Gold Bonds of this Company as therein set forth; and

Further Resolved, that the stockholders of this corporation hereby authorize, consent to, approve and sanction the making of such Indenture of Mortgage and the execution and delivery thereof to J. C. Lewis, as Trustee, and the issuance of the First Mortgage 6% Serial Gold Bonds of this corporation, as therein set forth; and the stockholders of this company hereby ratify, approve, sanction and confirm the execution and delivery of said Indenture of Mortgage and the execution and delivery of said First Mortgage 6% Serial Gold Bonds by the proper officers of this corporation, and the authentication thereof by the Trustee under said Indenture; and

Further Resolved, that the stockholders of this company hereby approve, sanction, ratify and confirm the execution and delivery to the Trustee under said Indenture, and authentication and delivery by him in accordance with the provisions of said Indenture, of Seven Hundred Fifty Thousand Dollars (\$750,000.00) principal amount of this corporation's First Mortgage 6% Serial Gold Bonds, either temporary or definitive, issuable under Article II of said Indenture, and the Trustee is hereby requested to authenticate and deliver said bonds under and pursuant to the provisions of said Indenture; and

[fol. 255] Further Resolved, that the stockholders of this corporation hereby authorize the officers of the corporation executing the Indenture of Mortgage referred to in the foregoing resolution, prior to the execution and delivery

thereof, to make such changes therein, as said officers shall approve, such approval to be evidenced by their execution of said Indenture as actually delivered.

The chairman stated that there was no further business to come before the meeting, and upon motion duly made, seconded and unanimously carried it was voted to adjourn.

(Signed) : E. J. Crofoot, Chairman.

True Record : (Signed) : R. G. Wertz, Secretary.

(cc EM 7/26/37)

EXHIBIT 9

Gulf Coast Water Company Agreement for the Holding of a Special Meeting of Directors

We, the undersigned, being all of the directors of Gulf Coast Water Company, a corporation organized under the laws of the State of Texas, do hereby severally agree that a special meeting of the board of directors of said corporation may be held at the office of the corporation, Bay City, Texas, at any hour during the day of Nov. 4th, 1931, for the purpose of considering and acting upon any and all matters that may be brought before the meeting incident to the business and affairs of the corporation, including particularly, without limiting the generality of the foregoing, the following:

[fol. 256] To approve and authorize the acquisition of all of the properties, assets and business of Gulf Coast Irrigation Company in exchange for Fifty Thousand Dollars (\$50,000.00) in cash, and Seven Hundred Fifty Thousand Dollars (\$750,000.00) in principal amount of the First Mortgage 6% Serial Gold Bonds of this corporation; to authorize the creation of the bonded indebtedness of this corporation in the amount of Seven Hundred Fifty Thousand Dollars (\$750,000.00), and to approve and authorize the execution of an Indenture of Mortgage, and the creation of a first lien against said properties, assets and business, securing the payment of said bonds; and to consider and act upon any and all other matters coming before said meeting.

We hereby severally waive any and all notice of said meeting, whether the same be required by the statutes of

the State of Texas, by the by-laws of this corporation, or otherwise.

Dated this the 4th day of November, 1931.

(Signed) E. J. Crofoot, R. G. Wertz, K. D. Horton.

(cc EM 7/26/37)

EXHIBIT 10

Gulf Coast Water Company Minutes of Special Meeting of Directors

Pursuant to the foregoing agreement for the holding of a special meeting of the board of directors of Gulf Coast Water Company, signed by all of the members of the board, a special meeting of the board was held at the office of the company, Bay City, Texas, at 9:30 o'clock, A. M., on this 4th day of Nov. 1931.

[fol. 257] There were present at said meeting the following directors:

(Signed) E. J. Crofoot, R. G. Wertz, K. D. Horton.

Mr. E. J. Crofoot, president of the company, presided as chairman of the meeting, and Mr. R. G. Wertz, secretary of the company, acted as secretary of the meeting.

The waiver of notice and agreement for the holding of the meeting was examined, approved and ordered inserted in the minute book of the company.

The chairman stated that since a majority of the members of the board were present the meeting was duly organized and ready for the transaction of business. Thereupon, the secretary presented and read to the meeting the resolutions adopted at a special meeting of the stockholders of the corporation held at an earlier hour on this date, approving the acquisition of the properties, assets and business of Gulf Coast Irrigation Company in exchange for \$50,000.00 in cash and \$750,000.00 in principal amount of the First Mortgage 6% Serial Gold Bonds of this company. He stated that the acquisition of said properties, assets and business would be carried out pursuant to a plan of reorganization of Gulf Coast Irrigation Company evidenced by a contract entered into between it and this company dated 4th day of Nov., 1931. The plan of reorganization and contract were submitted to the meeting. The chairman

then stated that it was in order for the directors to adopt appropriate resolutions carrying the transaction into effect, and authorizing appropriate action by the officers of this corporation in order that the same might be consummated, which resolution should also include the approval and authorization of the creation of a bonded indebtedness of this [fol. 258] company evidenced by the \$750,000.00 in principal amount of its First Mortgage 6% Serial Gold Bonds secured by a first lien upon the properties and assets acquired, together with the approval of the form of indenture and the execution and delivery thereof under which said bonds would be issued.

Upon motion duly made, seconded and unanimously carried it was

Resolved, that the Board of Directors of this corporation hereby approves, ratifies and confirms the plan of reorganization under which the interest of Gulf Coast Irrigation Company in its properties, assets and business will be reorganized by the conveyance and transfer of said properties, assets and business to this corporation in exchange for Fifty Thousand Dollars (\$50,000.00) in cash and First Mortgage 6% Serial Gold Bonds of this corporation in the principal amount of Seven Hundred Fifty Thousand Dollars (\$750,000.000); and does hereby authorize and empower the president or any vice president, and the secretary or any assistant secretary, and the treasurer or any assistant treasurer of this corporation to do and perform any and all acts necessary and proper in order to carry out and consummate said exchange, reorganization and the contract of November 4th, 1931; and

Further Resolved, that the form of Indenture of Mortgage to be dated as of September 1, 1931, a copy of which was submitted to this meeting, be and the same hereby is approved and the secretary of this corporation is instructed to mark said copy for identification and file the same among the records of this corporation; and

[fol. 259]. Further Resolved, that the President or any vice president, and the secretary or any assistant secretary of this corporation be and the said officers hereby are authorized and directed, in the name and on behalf of this corporation, and under its corporate seal, to execute, acknowledge and deliver to J. C. Lewis, as trustee, the indenture of mortgage of substantially the form of indenture which

has been submitted to this meeting, and that said indenture of mortgage shall be dated as of September 1, 1931, may cover all of the property, franchises, licensees, contracts and assets of the corporation, and the said officers of this corporation are hereby authorized, empowered and directed, prior to the execution and delivery of said indenture, to insert therein proper description of the properties, franchises, licenses, contracts and assets of this corporation to be included therein, and to make such changes in said indenture as they shall approve, such approval to be evidenced by the execution of said indenture as actually delivered; and

Further Resolved; that the directors of this corporation do hereby authorize, consent to, approve, ratify and sanction the creation of the bonded indebtedness of this corporation to the extent of Seven Hundred Fifty Thousand Dollars (\$750,000.00), and the issuance and delivery of this corporation's First Mortgage 6% Serial Gold Bonds in the principal amount of Seven Hundred Fifty Thousand Dollars (\$750,000.00), the same to be issued under and pursuant to the terms and provisions of the indenture of mortgage dated as of September 1, 1931, and which has been submitted to this meeting, and the president, or any vice-president and the [fol. 260] secretary or any assistant secretary of this corporation be and they hereby are authorized and directed to execute, under the corporate seal of this corporation, and to deliver to J. C. Lewis, as trustee, for authentication and delivery by him in accordance with the provisions of said indenture of mortgage the Seven Hundred Fifty Thousand Dollars principal amount of bonds, either temporary or definitive, hereby authorized and the trustee is hereby requested to authenticate and deliver said bonds under and pursuant to the provisions of said indenture of mortgage; and

Further Resolved, that in case any officer who shall have signed and sealed any of said bonds shall cease to be such officer of the corporation before the bonds so signed and sealed shall be actually authenticated and delivered by said trustee, such bonds are nevertheless hereby authorized by the corporation and may be authenticated and delivered and issued as though the persons who have signed and sealed such bonds had not ceased to be an officer of the corporation; and any of said bonds may be signed and sealed on behalf of the corporation by such persons as at the

actual date of the execution of such bonds shall be the proper officer of the corporation, although at the date of such bonds such person shall not have been an officer of the corporation; and

Further Resolved, that the president and any vice-president, the treasurer and any assistant treasurer, the secretary and any assistant secretary, and all other officers of the corporation, be and they hereby are each authorized and directed, on behalf of the corporation, to take all such [fol. 261] steps and to do and authorize to be done all such acts and things as may be necessary or advisable or convenient and proper for the purpose of carrying out the foregoing resolutions to the intent thereof, and for the purpose of effectuating and carrying out the execution and delivery of said indenture of mortgage and the issuance of said bonds, and the exchange of the sum of Fifty Thousand Dollars (\$50,000) in cash and the entire principal amount of the bonds authorized hereunder for the properties, business and assets of Gulf Coast Irrigation Company, pursuant to and in accordance with the plan of reorganization and contract hereinbefore described.

The chairman stated that there was no further business to come before the meeting, and thereupon on motion duly made, seconded, and unanimously carried it was voted to adjourn.

(Signed): E. J. Crofoot, Chairman.

A true record: (Signed): R. G. Wertz, Secretary.

(cc EM 7/26/37)

EXHIBIT 11

(Gulf Coast Water Co.)

Telegram

I am ready to execute deed and close title to these properties. Please name a day when you can meet me here for that purpose. Numerous objections have been raised by your attorneys, but practically all of them are easily answered and I consider none of them as having any real merit. Most of the objections run to the fact that fee title has not been secured to right of way. Your contract is satisfied with an easement alone. If you want to discuss

[fol. 262] the objections that your attorneys have made we will be glad to go over them with you at the time you come here to close the transaction.

(Signed): V. L. LeTulle.

(cc EM 7/26/37)

EXHIBIT 12

October 19, 1931.

B. E. Buckman & Company,
Beaver Building,
Madison, Wis.

Dear Buck:

I was in Judge Wharton's office in Houston Saturday and discussed for a few minutes the contract you forwarded to them. They are asking for permission to make a number of changes, some of which I see no objection to and some that I don't believe we should consider. I asked him to prepare the contract and send it over here, and I will then send it on to you.

One of the chief changes they want to make is the date of the bonds. They are asking that they be dated August first instead of September first. Another change is in the paragraph that calls for LeTulle being responsible for all willful or gross negligence, fraud, etc. They want to insert here that we are responsible for ordinary lawsuits arising from the operation. They also want to change Paragraph "D" of Article 4 to read more clearly that we are responsible for the operating expenses for the year 1931. These are the only changes I remember their wanting to make. I will forward you the corrected copy as soon as I receive it.

Holland has completed the descriptions of real property to be conveyed. I have prepared and submitted to LeTulle a copy of the personal property to be conveyed. He did not have time to talk to me when I gave him this copy. He [fol. 263] later sent it up with the elevating grader that we have discussed, eliminated. I have not had an opportunity of talking to him since.

I will, as you suggest in your letter, have all of our little operating expenses, etc., straightened out before the contract is signed.

Yours very truly, Interstate Public Service Co.,
E. J. Crofoot.

(cc EM 7/26/37)

EXHIBIT 13

November 4, 1931.

B. E. Buckman & Company,
Beaver Building,
Madison, Wis.

Attention: Mr. B. E. Buckman

Dear Buck:

Relative to the changes Wharton and LeTulle want to make in the trust indenture, it is all in the one section known as "Article Six". I presume that Steve has an exact copy of this Article which he received with the original indenture from Wharton. As you know, this Article provides for the selling of property in case of foreclosure after four weeks notice in the local paper. The law here requires that any property under sale shall be sold the first Tuesday in the month. Consequently, in most instances after default on January first a four weeks notice would carry beyond the first Tuesday in February and would make the sale come the first Tuesday in March. It is, however, entirely possible that the four weeks notice could be completed by the first Tuesday in February. This condition under the trust indenture exists only in the case of [fol. 204] default in principal. If there is default in interest we must be given sixty days notice, then the sale advertised for four weeks.

I did everything I could to put the default in principal in the same category, but they would not stand for it because it would throw the sale in May after the irrigation season should have started.

They also contended that our nine months period should date from September first. I believe Kiley is responsible for this. However, I got LeTulle to agree to November first, and have not given up trying for January first.

The exhibit of operating expenses will be considerably more than you had anticipated because I insisted upon their putting in the taxes for 1931 and Mr. LeTulle's salary, together with some small losses that have already been sustained. This was done so there would be no question about how these operating expenses were to be taken care of.

Every schedule and contract has been examined very carefully and I can find nothing that has been changed.

I will certainly be glad when this is out of the way because they have been rather hard to live with during the past month.

Rice is moving much better now, and there is a general feeling of optimism, and I think we can look for a good portion of this rice to be moved by January first.

Yours very truly, Interstate Public Service Co.,
E. J. Crofoot.

EJC/ml
(cc EM 7/26/37)

[fol. 265]

EXHIBIT 14

November 7, 1931.

B. E. Buckman & Company,
Beaver Building,
Madison, Wis.

Gentlemen:

We have about completed our arguments, and we will mail to you some time today a copy of all of the exhibits and contract.

I have a letter from Judge Wharton this morning inclosing *Meetings of Stockholders Meetings, Waivers, etc.* He says in this letter that he has mailed a copy to Stephens and Holland. Will you please have Steve advise me by wire if these are satisfactory.

I would like to have you call Steve's attention to the fact that Eldorado should be transferred from the Gulf Coast Water Company back to the Central West Water & Power Company prior to November 4th. I have never received a deed from him transferring Eldorado from the Central West to me. This deed should be dated prior to September 28th.

Wharton and Davant, as well as LeTulle, are bending every effort to hurry the transaction along. After the deed is prepared, I will forward it to you together with the form of bond, etc. Can you give me any idea of when your arrangements can be completed.

Rice is being sold here now at a lively clip. The price has not advanced during the last ten days, but there certainly is a demand. There has been to date two hundred and one thousand (201,000) bags sold.

Yours very truly, Interstate Public Service Co., E. J.
Crofoot.

EJC/ml
(cc EM 7/26/37)

[File endorsement omitted.]

In United States District Court

ORDER DENYING AND OVERRULING DEFENDANT'S MOTION FOR NEW TRIAL—Filed May 2, 1938

On this day came on to be heard motion for new trial filed by the defendant in the above-entitled and numbered cause, and the court after considering the same, is, of the opinion that the same should be denied and overruled.

It is, Therefore, Ordered that the motion for new trial filed in this cause by the defendant be, and the same is hereby, denied and overruled, to which action of the court defendant in open court excepted.

Done at San Antonio, Texas, this 2nd day of May, A. D. 1938.

Robert J. McMillan, United States District Judge.

(File endorsement omitted.)

[fol. 267] In United States District Court

MOTION FOR ADDITIONAL ENLARGEMENT OF TIME WITHIN WHICH TO SETTLE AND FILE BILL OF EXCEPTIONS—Filed July 14, 1938

Now comes the defendant, Frank Scofield, United States Collector of Internal Revenue, for the First District of Texas, and respectfully represents to the court that final judgment was entered in this cause in favor of the plaintiff on April 29, 1938; that order overruling the motion for a new trial was denied by the court on May 2, 1938; that in the judgment entered in this consolidated cause the court enlarged and extended the time within which to settle and file the Bill of Exceptions for the full three months period within which to take appeal; that the time for settling and filing said Bill of Exceptions expires on July 29, 1938; that the Attorney General and the Solicitor General of the United States have just determined that an appeal should be taken, and due to the fact that the record is voluminous, it will be impossible to prepare and settle and file the Bill of Exceptions on or prior to July 29, 1938.

Wherefore, he prays that the time for settling and filing the Bill of Exceptions in this cause be enlarged and extended for a period of ninety (90) days from July 29, 1938.

W. R. Smith Jr., United States Attorney, Attorney
for Defendant.

(File endorsement omitted.)

[fol. 268] In United States District Court

ORDER ALLOWING ADDITIONAL ENLARGEMENT OF TIME WITHIN WHICH TO SETTLE AND FILE BILL OF EXCEPTIONS—Filed July 14, 1938

On this day came on to be heard motion of the defendant, Frank Scofield, United States Collector of Internal Revenue for the First District of Texas, for an additional enlargement and extension of time within which to settle and file the Bill of Exceptions in this cause, and it appearing to the court for the reasons mentioned in said motion that the time should be so enlarged.

It is, Therefore, Ordered that the time for settling and filing the Bill of Exceptions in this cause by the defendant be, and the same is hereby, enlarged and extended for a period of ninety (90) days from July 29, 1938. Done at San Antonio, Texas, this 14th day of July, A. D. 1938.

Duval West, United States District Judge.

Entered: Vol. L. Pg. 710.

(File endorsement omitted.)

[fol. 269] In United States District Court

PETITION FOR APPEAL—Filed July 23, 1938

To the Honorable Robert J. McMillan, Judge of the United States District Court for the Western District of Texas, Austin Division:

The defendant, Frank Scofield, Collector of Internal Revenue for the First District of Texas, feeling himself aggrieved by the final judgment and order rendered and entered in the above-entitled cause on the 29th day of April, 1938, motion for rehearing and new trial being denied on the 2d day of May, 1938, which said judgment and order was rendered in favor of the plaintiff, V. L. LeTulle, and against the defendant, Frank Scofield, Collector of Internal Revenue, does hereby appeal from said judgment and order to the United States Circuit Court of Appeals for the Fifth Circuit, for the reasons specified in his assignment of errors, which is filed herewith, and he prays that an appeal be

allowed and that citation be issued as provided by law, and that a transcript of the record, proceedings, and papers, upon which said judgment and order was based, duly authenticated, be sent to the Circuit Court of Appeals of the United States for the Fifth Circuit, sitting at New Orleans, Louisiana, under the rules of such court in such cases made and provided.

W. R. Smith Jr., United States Attorney, Attorney
for defendant.

[fol. 270]

(Caption omitted)

Nos. 1412, 1413 Law Consolidated

The undersigned, as attorneys of record for the plaintiff-appellee herein, hereby acknowledge receipt of a true and correct copy of the foregoing petition for appeal and order of the Court thereon, and waive issuance and service of citation on the same.

W. E. Davant, Homer L. Bruce, Attorney- for V. L.
LeTulle.

Dated this 23rd day of July, 1938.

(File endorsement omitted.)

In United States District Court

ASSIGNMENT OF ERRORS—Filed July 23, 1938

Frank Scofield, Collector of Internal Revenue, defendant in the above-entitled and numbered causes, respectfully states that the judgment made and entered against him in the above-entitled cause on the 29th day of April, A. D., 1937, is erroneous and against the just rights of the said defendant for the reasons hereinafter assigned and set forth, and said defendant files with his petition for appeal herein the following assignment of errors upon which he will rely for the prosecution of the appeal herein, and assigns the following errors which he asserts were committed in the record, proceedings, and judgment in said cause, to the prejudice of the defendant, and which he intends to urge in the United States Circuit Court of Appeals for the Fifth Circuit, to wit:

[fol. 271] 1. The Court erred in declaring as a matter of law that the plaintiff was entitled to judgment and in entering order of judgment in favor of said plaintiff.

2. The Court erred in granting plaintiff's motion for judgment.

3. The Court erred in finding the facts as requested by the plaintiff.

4. The Court erred in making conclusion of law number 1, to wit:

The transaction in November, 1931, under which Gulf Coast Irrigation Company transferred substantially all of its properties to Gulf Coast Water Company for \$50,000 in cash and \$750,000 in bonds of Gulf Coast Water Company, and dissolved and distributed its assets to plaintiff as its sole stockholder, was a tax free reorganization and Gulf Coast Irrigation Company realized no taxable gain on account thereof. For the fiscal period ended November 21, 1931, Gulf Coast Irrigation Company had no taxable income in excess of that reported upon its original return and paid thereon, and the additional tax paid by plaintiff as transferee of Gulf Coast Irrigation Company for said period was erroneously assessed and collected, and plaintiff is entitled to recover from the defendant the \$36,422.83 tax and \$4,496.47 interest thereon, which plaintiff paid to the defendant on June 21, 1934, with interest on both of said sums at the rate of six per cent (6%) per annum from June 21, 1934.

5. The Court erred in making conclusion of law number 2, to wit:

Upon the dissolution and liquidation of Gulf Coast Irrigation Company, plaintiff received a taxable gain only to the [fol. 272] extent of the cash and fair value of other property received by him, exclusive of the bonds, of a total value of \$94,762.17.

6. The Court erred in failing to find that the transaction of November, 1931, whereby the taxpayer, V. L. LeTulle, transferred substantially all of the properties of the Gulf Coast Irrigation Company to the Gulf Coast Water Company for \$50,000 in cash and \$750,000 in bonds of Gulf Coast Water Company was taxable not only with respect to the cash received but also the \$750,000 in bonds.

7. The Court erred in failing to affirm the determination of the Commissioner of Internal Revenue that the transaction in November, 1931, whereby V. L. LeTulle transferred substantially all of the properties of the Gulf Coast Irrigation Company to the Gulf Coast Water Company for \$50,000 in cash and \$750,000 in bonds was not a reorganization within the meaning of Section 112 of the Revenue Act of 1928.

8. The Court erred in failing and refusing to make conclusion of law number 1 requested by the defendant, as follows:

That the transaction whereby the assets of the Gulf Coast Irrigation Company were transferred to the Gulf Coast Water Company for cash and bonds was a sale and not a reorganization as defined by Section 112 (i) of the Revenue Act of 1928.

9. The Court erred in failing and refusing to make conclusion of law number 2 requested by the defendant, to wit:

That V. L. LeTulle did not acquire a definite, material and substantial interest in the affairs of the Gulf Coast [fol. 273] Water Company in the disposition by him in 1931 of the stock of the Gulf Coast Irrigation Company, which interest represented a substantial part of the value of said shares of stock disposed of by him.

10. The Court erred in failing and refusing to make conclusion of law number 3 requested by the defendant, to wit:

That the taxable profit derived by V. L. LeTulle in 1931 from the disposition of all the shares of the Gulf Coast Irrigation Company was not limited to the amount of cash received by him in 1931, but also included the then value of the bonds received in lieu of cash under the provisions of Section 112 (c) (1) of the Revenue Act of 1928.

11. The Court erred in failing to make conclusion of law number 4 requested by the defendant, to wit:

That the taxable profit derived in 1931 by V. L. LeTulle from the disposition of shares of stock of the Gulf Coast Irrigation Company was the difference between the sum of the cash, the value of the bonds of the Gulf Coast Water

Company received in 1931, less the cost to him of said shares of stock in the Gulf Coast Irrigation Company.

12. The Court erred in failing and refusing to make conclusion of law number 5 requested by the defendant, to wit:

That plaintiff was taxable upon both the cash and the fair market value of the bonds received by him in payment of said transaction.

13. That the Court erred in failing and refusing to grant the defendant's motion for continuance filed on July 5, 1937, for the reason, as alleged in said motion, that the defendant, subsequent to the hearing on June 24, 1937, had [fol. 274] discovered certain new and additional evidence and had asked the Court to issue subpoenas for the attendance of witnesses who would be able to testify in regard thereto. The subpoenas were issued, but prior to the service thereof the Court entered an order quashing the same and the defendant was deprived of the right to have witnesses present to testify concerning the matters set out in said motion for continuance filed on July 5, 1937.

14. That the Court erred in failing and refusing to grant a continuance as requested on July 5, 1937, on account of the matters and things set out in said motion for continuance, which subsequent developments have shown would present an entirely different state of facts under which the Court would be compelled to find for the defendant on the question of whether or not a taxable reorganization resulted from the transaction between V. L. LeTulle, Gulf Coast Irrigation Company, and Gulf Coast Water Company.

15. The Court erred in failing and refusing to grant the defendant's motion for continuance, filed on July 5, 1937, for the reason that had defendant been permitted to produce the evidence alleged and shown to be available the defendant would have conclusively proven that the contract under which the sale of the properties of the Gulf Coast Irrigation Company, owned by V. L. LeTulle, were transferred to the Gulf Coast Water Company was not the contract of November 5, 1931, but, on the contrary, was a binding contract entered into between V. L. LeTulle and B. E. Buckman and Company of Madison, Wisconsin, on or about November 5, 1930, which said contract was sold and transferred to various corporations and individuals controlled by

the said B. E. Buckman and Company until it reached the hands of the officers of the Gulf Coast Water Company, a [fol. 275] corporation created for the purpose of carrying out the terms of the said contract in November, 1930, between V. L. LeTulle and B. E. Buckman and Company.

16. The Court erred in failing to grant said motion for continuance filed on July 5, 1937, because the defendant would have been able to show an entirely different state of facts from that upon which the Court's conclusion was based, which would have compelled a finding in favor of the defendant and against the plaintiff.

17. The Court erred in failing and refusing to grant the defendant's motion for new trial, filed on May 2, 1938, because the said motion conclusively demonstrated that the Court erred in failing and refusing to grant the continuance asked on July 5, 1937, in that the said motion for new trial, with the exhibits attached, demonstrates that the facts upon which the judgment in this case was based are not the true facts having to do with the contract and sale of the assets of the Gulf Coast Irrigation Company.

18. The Court erred in failing and refusing to grant the motion for new trial filed on May 2, 1938, because had the defendant been given an opportunity to prove the facts set out in said motion for new trial it would have been conclusively demonstrated that the transaction in question whereby Gulf Coast Water Company was alleged to have acquired the assets of Gulf Coast Irrigation Company, owned by plaintiff, V. L. LeTulle, was an outright sale under the provisions of the contract dated on or about November 5, 1930, between B. E. Buckman and Company and the plaintiff, V. L. LeTulle, instead of a reorganization as alleged by the plaintiff in his said petition.

[fol. 276]. 19. The Court erred in failing and refusing to grant motion for new trial filed on May 2, 1938, because the newly discovered evidence alleged therein had a direct bearing on the case and the delay occasioned by the continuance would have given the defendant an opportunity to show the true facts relative to the transaction whereby the plaintiff V. L. LeTulle, transferred the properties of the Gulf Coast Irrigation Company to the Gulf Coast Water Company, and thereby have prevented a grave miscarriage of justice.

Wherefore, defendant prays that the judgment entered be reversed and rendered in favor of the defendant, and if the cause be not reversed and rendered that it be reversed and remanded for a new trial.

Dated this 23rd day of July, 1938.

W. B. Smith, Jr., United States Attorney. Lester L. Gibson, Special Assistant to the Attorney General, Attorneys for defendant.

[File endorsement omitted.]

[fol. 277] IN UNITED STATES DISTRICT COURT

ORDER ALLOWING APPEAL—Filed July 23, 1938

Considering the petition for appeal this day presented together with the accompanying assignment of errors filed herein by the defendant, it is hereby ordered that an appeal be allowed to Frank Scofield, Collector of Internal Revenue for the First District of Texas, defendant herein, to the United States Circuit Court of Appeals for the Fifth Circuit from the judgment and order heretofore filed and entered herein on April 29, 1938, motion for rehearing and new trial having been denied on May 2, 1938, and that a certified transcript of the record, testimony, exhibits, stipulations and all proceedings be forthwith transferred to the United States Circuit Court of Appeals for the Fifth Circuit, sitting at New Orleans, Louisiana.

Dated at San Antonio, Texas, July 23rd, 1938.

Duval West, United States District Judge.

Ent'd: Min. Vol. L, page 712.

[fol. 278] IN UNITED STATES DISTRICT COURT

MOTION FOR EXTENSION OF TIME WITHIN WHICH TO DOCKET CAUSE IN CIRCUIT COURT OF APPEALS—Filed July 23, 1938

Now comes the defendant, Frank Scofield, United States Collector of Internal Revenue for the First District of

Texas, and respectfully represents to the court that on the 23rd day of July, 1938, an order was entered in this cause allowing the defendant to appeal this cause to the United States Circuit Court of Appeals for the Fifth Circuit; that the Bill of Exceptions has not been filed in this cause due to the fact that defendant has not had sufficient time in which to prepare the same, but that an order has been entered by this court extending and enlarging the time for the settling and filing thereof for a period of ninety days from July 29, 1938, and that defendant will not have sufficient time within which to prepare and print the record to be filed in the Circuit Court within the thirty days provided by Rule XIV.

Wherefore, he prays for an order extending the time for docketing this cause in the Circuit Court for a period of sixty (60) days after the 22nd day of August, 1938, said latter date being the thirtieth day after the order was entered allowing appeal, together with waiver of citation by plaintiff, as is provided by Rule XVI of the Rules of the United States Circuit Court of Appeals for the Fifth Circuit.

W. R. Smith, Jr., United States Attorney, Attorney
for Defendant

[File endorsement omitted.]

[fol. 279] IN UNITED STATES DISTRICT COURT

ORDER ENLARGING THE TIME WITHIN WHICH TO DOCKET
THE CAUSE IN THE CIRCUIT COURT—Filed July 23, 1938

On this day came on to be heard motion of the defendant, Frank Scofield, United States Collector of Internal Revenue for the First District of Texas, for an order extending the time within which to docket this cause in the United States Circuit Court of Appeals for the Fifth Circuit, and it appearing to the court for the reasons mentioned in said motion that the time should be extended,

It is, Therefore, Ordered that the time within which defendant shall docket this cause in the United States Circuit Court of Appeals for the Fifth Circuit be, and the same is hereby, extended for a period of sixty (60) days from the 22nd day of August, 1938.

Done at San Antonio, Texas, this 23rd day of July, A. D. 1938.

DuVal West, United States District Judge.

Entered Min. Vol. L, page 714.

[File endorsement omitted.]

[fol. 280] IN UNITED STATES DISTRICT COURT

PRAECIPE FOR TRANSCRIPT OF RECORD—Filed Sept. 16, 1938

To Honorable T. Maxey Hart, Clerk, United States District Court for the Western District of Texas:

You are hereby requested to make a transcript of record in the above numbered and entitled cause in said Court for transmission upon appeal to the United States Circuit Court of Appeals for the Fifth Circuit from the judgment and order of the United States District Court for the Western District of Texas, Austin Division, rendered and filed herein on April 29, 1938, in favor of plaintiff, V. L. LeTulle, and against the defendant, Frank Scofield, and, in making up said transcript, to include therein the following pleadings, papers, orders and documents:

1. Plaintiff's Original Petition in Cause Number 1412 Law.
2. Defendant's Answer in Cause Number 1412 Law.
3. Plaintiff's First Amended Original Petition in Cause Number 1413 Law.
4. Defendant's Answer in Cause Number 1413 Law.
5. Order Consolidating Causes for Trial.
6. Defendant's Motion for Continuance.
7. Order Denying Defendant's Motion for Continuance.
8. Judgment.
9. Bill of Exceptions.
10. Defendant's Motion for a New Trial.
11. Order Denying Defendant's Motion for New Trial.
12. Defendant's Motion for Enlargement of the Time Within Which to Settle and File the Bill of Exceptions.
13. Order Enlarging the Time Within Which to Settle and File Bill of Exceptions.

[fol. 281] 14. Defendant's Petition for Appeal, including Plaintiff's waiver of citation upon appeal.

15. Defendant's Assignment of Errors.

16. Order Allowing Appeal.

17. Defendant's Motion for Enlargement of Time Within Which to Docket the Cause in the Circuit Court.

18. Order Enlarging The Time Within Which to Docket Cause in Circuit Court.

19. Praecipe.

20. Certificate of Clerk,

Dated this 15th day of September, A. D. 1938.

W. R. Smith, Jr., United States Attorney; H. W. Moursund, Assistant United States Attorney; Attorneys for Defendant.

Service of a copy of the foregoing accepted and receipt of a copy thereof acknowledged this 15th day of September, A. D. 1938.

W. E. Davant, Homer L. Bruce, Attorneys for Plaintiff.

[File endorsement omitted.]

[fol. 282] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 283] That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:

ARGUMENT AND SUBMISSION

Extract from the Minutes of February 23rd, 1939

No. 8948

FRANK SCOFIELD, United States Collector of Internal Revenue for the First District of Texas,
versus

V. L. LETULLE

On this day this cause was called, and, after argument by Miss Helen R. Carlross, Special Assistant to the Attorney General, for appellant, and Homer L. Bruce, Esq., for appellee, was submitted to the Court:

[fol. 284] OPINION OF THE COURT—Filed April 3, 1939

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE
FIFTH CIRCUIT

No. 8948

FRANK SCOFIELD, United States Collector of Internal Revenue for the First District of Texas, Appellant,
versus

V. L. LETULLE, Appellee

Appeal from the District Court of the United States for the Western District of Texas

(April 3, 1939)

Before Foster, Sibley and McCord, Circuit Judges

SIBLEY, Circuit Judge:

V. L. LeTulle was compelled by the Collector of Internal Revenue to pay additional income taxes for the year 1931

assessed against himself and wife in community who as sole stockholders received in distribution all the assets of Gulf Coast Irrigation Company, which was dissolved Nov. 18, 1931, after having sold all its property and business to Gulf Coast Water Company on Nov. 4, 1931. The sale trans-[fol. 285] action the Commissioner thought realized a taxable gain to the Irrigation Company, and he held that the LeTulles owed the tax as transferees of the corporate assets, and that they themselves realized taxable gains by the distribution of the assets in liquidation. LeTulle (his wife being deceased leaving him her representative and heir) contended the transactions were an untaxed reorganization of the Irrigation Company, sought refund of the additional taxes paid, and then sued the Collector in the District Court; where on a trial before the judge without jury he obtained judgment for \$110,234, with interest and cost.

The Collector appealing contends there was no untaxed reorganization of the Irrigation Company, but a gain-realizing sale camouflaged to escape taxation; and that the court erred in not granting him time to show that the contract of sale on Nov. 4, 1931, which purported to be a reorganization, was really the consummation of one made with another purchaser a year previous, and transferred, which did not purport to be a reorganization.

The purchasing corporation, Gulf Coast Water Company, was owned by interests wholly apart from the LeTulles, and was organized for the purpose of making this purchase. It apparently had little capital, and found difficulty in making the cash payment. The contract of Nov. 4, 1931, stated that the Irrigation Company desired to reorganize its interests by transferring them to the Water Company for cash and the securities of the Water Company, and that LeTulle desired to reorganize his interest in the properties of the Irrigation Company so they would be represented by said cash and securities, and that all three joined in a plan of reorganization. In consideration of \$25,000 cash, and \$25,000 to be paid on executing a conveyance, and bonds of the Water Company in a sum of \$750,000, bearing 6% annual [fol. 286] interest, \$150,000 payable on or before Jan. 1, 1933, and the remainder \$50,000 per year beginning Jan. 1, 1933, all to be delivered to the Irrigation Company, it was to convey to the Water Company by warranty deed extensive irrigation properties and business fully described. The bonds were to be secured by mortgage on the property and

the Water Company was to have the option within nine months from Jan'y. 1, 1932, of taking up the \$600,000 longer term bonds for \$500,000 and interest. The shorter term bonds were further secured on the profits of operation of the business by a pledge of the net water rents. Neither LeTulle nor the Irrigation Company were to engage in the water business in named counties for thirty years. The conveyance, cash and bonds were delivered on Nov. 17, 1931. The Irrigation Company dissolved Nov. 18, 1931, and paid over the proceeds of sale to LeTulle as sole stockholder. He collected during 1931 on the first maturing bonds \$76,648. It does not clearly appear what has been paid since. The court found the short term bonds had a market value of 100 and the others of 75.

A sale of its property by a corporation for money or securities having a market value in excess of the cost of the property ordinarily realizes a taxable gain; as does the receipt by a stockholder of liquidating dividends in excess of his investment in his stock. The tax laws except from this general rule the case of the reorganization or merger of a corporation, and the immediate distribution to its stockholders in pursuance of a plan of reorganization of the proceeds. Rev. Act of 1928, Sect. 112 (b) (4), 112(d) (1). In such a case it is considered that there is no real sale, and the stockholder has not finally realized on his stock investment, but will owe a tax on his potential gain only when he realizes it by sale or collection of the new securities received. For it is characteristic of reorganizations that the purchaser's stock or [fol. 287] other securities are received for the corporate properties, and receipt of these only is protected from present taxation. What transactions are to be considered reorganizations has been defined by the statute, Sect. 112(i). The part of it applicable here reads: "The term reorganization means (A) a merger or consolidation, (including the acquisition by one corporation of at least a majority of voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or *substantially all of the properties of another corporation*). Since the Water Company here acquired substantially all the properties of the Irrigation Company, there was a merger of the latter, according to the literal language. But it is settled that pure sales of substantially all of a corporation's property are not to be included, so that where the consideration paid for all the properties was half cash and

the other half short term well-secured notes there was not a merger but a sale. *Pinellas Ice & Cold Storage Co. vs. Commissioner*, 287 U. S. 462. This doctrine was reaffirmed and developed in *Helvering vs. Minnesota Tea Co.*, 296 U. S. 378, but since about half the consideration there paid was in common stock of the purchasing company it was thought there was retained by the seller a substantial stake in the enterprise so that it would be a merger under the statute rather than a pure sale. So also in *Nelson vs. Helvering*, 296 U. S. 374, where the selling corporation received preferred stock in the buying corporation it was held there was a statutory reorganization by merger, since the seller retained "a definite and a substantial interest in the affairs of the purchasing corporation", though having no voting rights. The quoted words constitute, we think, the test. Long time notes or bonds of the purchasing corporation may, like preferred stock, represent a definite and substantial interest in the [fol. 288] purchaser's affairs.* The judge was justified in finding they did here. The cash paid was hardly more than a year's interest. The maker of the bonds had no independent financial strength. The security for them was only the property which was sold. If the affairs of the new company should prosper, the bonds would be paid, perhaps anticipated. If not, the seller would most likely only get its property back. There was a very substantial interest in the affairs of the purchasing corporation retained,—enough to make the words of the statute applicable, and to relieve the transaction as a reorganization from present full taxation.

There was no error in refusing postponement of the trial to secure evidence that the contract of Nov. 4, 1931, was really the consummation of a contract of sale on similar terms to another which did not call itself a reorganization.

* In *Helvering vs. Watts*, 296 U. S. 387, it was said that long term bonds were securities and not the equivalent of cash as the short term notes were held to be in the *Pinellas Ice Company* case. But the *Watts* case did not arise under the clause of the statute about acquiring substantially all of the properties of another corporation, but concerned the preceding clause about acquiring a majority of the stock. It did not really matter whether the bonds received were the equivalent of cash or not, as all the stock was acquired, which by itself made a reorganization.

The evidence would not have changed the result. Whether there was a reorganization depends on the things named in the statute and not on what the parties recite as to their intentions. The material terms of the old contract were the same as the new one.

We find a reason for reversing the judgment which has not been argued. It is stated in the contract of Nov. 4, 1931, that the Irrigation Company was then "the owner of certain pumping plants, intakes, machinery, canals . . . and prior to the conveyance hereinafter called for . . . will be the owner of certain other lands and irrigation properties, all of which said property to be conveyed shall be more [fol. 289] particularly described, etc." On Nov. 7, 1931, a meeting of the stockholders of the Irrigation Company was held at which the capital stock of the Company was increased from \$100,000 to \$266,000. The entire increase was thereupon subscribed for by LeTulle, and paid for in property conveyed to the Company at a price of \$166,000. The stockholders meeting then ratified the contract of Nov. 4, 1931, and authorized the conveyance of all its properties and business accordingly. The evidence thus plainly shows that a large part of the property conveyed under the contract of Nov. 4, 1931, was not at that date owned by the Irrigation Company but by LeTulle, and that he conveyed it to his company by the device above stated in order to transfer it to the purchaser along with the property of the Irrigation Company. The statute makes no provision for the "reorganization" of an individual. The "plan of reorganization" which the Irrigation Company and LeTulle signed with the Water Company operated as a reorganization of the Irrigation Company, but the property of LeTulle which was embraced in it was simply sold by him. Using the Irrigation Company as a conduit for passing the title does not alter the substance of the matter. Only so much of the consideration as represents the price of the properties and business of the Irrigation Company is entitled to be protected from taxation as arising from a reorganization. It does not appear what the proper apportionment is. The burden was upon LeTulle to show not only that he had been illegally taxed, but how much of what was collected from him was illegal. The latter he did not do. The evidence does not support the judgment for the full amount paid by him. It is accordingly [fol. 290] reversed, that further proceedings may be had consistent herewith.

Reversed and Remanded.

[fol. 291]

JUDGMENT

Extract from the Minutes of April 3rd, 1939

No. 8948

FRANK SCOFIELD, United States Collector of Internal Revenue for the First District of Texas,

versus

V. L. LETULLE

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Western District of Texas, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby, remanded to the said District Court that further proceedings may be had consistent with the opinion of this Court.

[fol. 296] ORDER DENYING REHEARING

Extract from the Minutes of April 27th, 1939

No. 8948

FRANK SCOFIELD, United States Collector of Internal Revenue for the First District of Texas,

versus

V. L. LETULLE

It is ordered by the Court that the petition for rehearing filed in this cause be, and the same is hereby, denied.

[fol. 297] MOTION AND ORDER STAYING MANDATE—Filed May 3, 1939

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT, AT NEW ORLEANS

No. 8948

FRANK SCOFIELD, United States Collector of Internal Revenue for the First District of Texas, Appellant,

vs.

V. L. LETULLE, Appellee

MOTION FOR ORDER STAYING MANDATE

To the Honorable Judges of Said Court:

Comes now V. L. LeTulle, appellee in the above entitled and numbered cause, and respectfully represents and shows to the court that it is his purpose to apply to the Supreme Court of the United States for a writ of certiorari therein at as early a date as practicable and within the time limited by law. He therefore prays the court to enter an order staying the issuance of the mandate in said cause for a

reasonable time within which the petition for said writ of certiorari may be prepared and filed.

Respectfully submitted, (Signed) W. E. Davant,
Homer L. Bruce, Attorneys for Appellee.

Subscribed and Sworn to before me, the undersigned authority, by Homer L. Bruce, this 28th day of April, 1939. (Signed) C. H. Wilson, Notary Public in and for Harris County, Texas. (Seal.)

[fol. 298] UNITED STATES CIRCUIT COURT OF APPEALS FOR
THE FIFTH DISTRICT

No. 8948

FRANK SCOFIELD, United States Collector of Internal Revenue for the First District of Texas, Appellant,

vs.

V. L. LETULLE, Appellee

On Consideration of the Application of the appellee in the above numbered and entitled cause for a stay of the mandate of this court therein, to enable appellee to apply for and to obtain a writ of certiorari from the Supreme Court of the United States, it is Ordered that the issue of the mandate of this court in said cause be and the same is stayed for a period of thirty days, the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within thirty days from the date of this order there shall be filed with the clerk of this court the certificate of the clerk of the Supreme Court that certiorari petition, and record have been filed, and that due proof of service of notice thereof under Paragraph 3 of Rule 38 of the Supreme Court has been given. It is further Ordered that the clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of thirty days from the date of this order, unless the above-mentioned certificate shall be filed with the clerk of this court within that time.

Done at New Orleans, La., this 3rd day of May, 1939.

(Signed) Rufus E. Foster, United States Circuit Judge.

[fol. 299]

CLERK'S CERTIFICATE

UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT

UNITED STATES OF AMERICA:

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 283 to 298 next preceding this certificate contain full, true and complete copies of all the pleadings, record entries and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said Court, numbered 8948, wherein Frank Scofield, United States Collector of Internal Revenue for the First District of Texas is appellant, and V. L. LeTulle is appellee, as full, true and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 282 are identical with the printed record upon which said cause was heard and decided in the said Circuit Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said United States Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 3rd day of May, A. D. 1939.

Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals, Fifth Circuit. (Seal United States Circuit Court of Appeals, Fifth Circuit.)

[fol. 300] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 9, 1939

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted.


And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Butler took no part in the consideration and decision of this application.

Endorsed on cover: File No. 43,464. U. S. Circuit Court of Appeals, Fifth Circuit. Term No. 63. V. L. LeTulle, petitioner, vs. Frank Scofield, United States Collector of Internal Revenue for the First District of Texas. Petition for a writ of certiorari and exhibit thereto. Filed May 22, 1939. Term No. 63, O. T., 1939.

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CHARLES ELMORE BROPLEY
CLERK

IN THE
Supreme Court of the United States
OCTOBER TERM, 1938

V. L. LETULLE, *Petitioner,*

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF
INTERNAL REVENUE FOR THE FIRST DISTRICT
OF TEXAS, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE FIFTH CIRCUIT AND SUPPORTING
BRIEF

W. E. DAVANT,
HOMER L. BRUCE,
Attorneys for Petitioner.

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No.

IN THE
Supreme Court of the United States
OCTOBER TERM, 1938

V. L. LETULLE, *Petitioner*,

V.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF
INTERNAL REVENUE FOR THE FIRST DISTRICT
OF TEXAS, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE FIFTH CIRCUIT

May It Please the Court:

The petitioner, V. L. LeTulle, respectfully prays for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit at New Orleans, Louisiana, to hear this cause and to review the decision of the Circuit Court of Appeals in reversing the judgment of the United States District Court for the Western District of Texas, Austin Division. Petitioner respectfully shows to this Honorable Court:

1.

Summary Statement of the Matter Involved.

For the purposes of the appeal in the Circuit Court

of Appeals and the hearing in this Court there is no dispute as to the facts.

Petitioner was the sole stockholder of Gulf Coast Irrigation Company. On November 18, 1931, the Irrigation Company, in pursuance of a plan of reorganization, entered into on November 4, 1931 (R. 75), conveyed substantially all of its properties to Gulf Coast Water Company (R. 110) for \$50,000 in cash and \$750,000 in bonds, maturing in installments over a period of eleven years from January 1, 1933, to January 1, 1944, secured by a mortgage or deed of trust upon all of the properties so conveyed. (R. 113-176.) On November 21, 1931, the Irrigation Company was dissolved and distributed the cash and bonds and its few remaining assets to petitioner, its sole stockholder. (R. 65, 195.)

The Irrigation Company for the fiscal period involved (April 1—November 21, 1931) and petitioner and his wife (all their property being community property) for the calendar year 1931 in their income tax returns treated the exchange of the properties for cash and bonds and the distribution by the Irrigation Company as a tax free transaction under Section 112 of the Revenue Act of 1928 (Appendix A of appended brief) except as to the cash and other property received by petitioner on the dissolution of the Irrigation Company.

In June, 1934, the Commissioner held that this was a sale and not a tax free reorganization and assessed a tax against petitioner as the transferee of the Irrigation Company on that basis and further taxes

against petitioner and his wife individually for 1931 on the same theory (R. 66-68, 70-74), all of which petitioner paid. In the meantime petitioner's wife had died and it was agreed that he was the proper party, as her sole heir and survivor of the community, to prosecute the suits here involved. (R. 70.)

Petitioner in 1934 filed appropriate claims for refund with the respondent, and in September, 1936, having been unable to obtain any action on his claims, filed these suits, whereupon the Commissioner rejected them. (R. 18, 68, 74.)

Petitioner filed two suits, one to recover the tax assessed against him as transferee of the Irrigation Company (R. 2) and the other the additional taxes paid for himself and wife individually. (R. 19.) Both suits were consolidated into one cause. (R. 40.) The petitions refer to many matters other than this reorganization, due to the fact that the Commissioner had made other adjustments of petitioner's tax liability. The District Court held against petitioner on all issues except that of the reorganization, recomputed his liability on the basis of its being tax free (R. 196-200), and rendered judgment for petitioner for the overpayments made by him on that basis. (R. 59.) Petitioner did not appeal from that judgment. Consequently, on the appeal of the respondent, the only issue before the Circuit Court of Appeals was that involving this reorganization, whether it was a tax free reorganization or a taxable sale (except that respondent also complained of the District Court's overruling his motion for continuance).

Aside from question of the motion for continuance, the respondent in the Circuit Court of Appeals assailed the judgment of the District Court on one and only one ground, and that was that, since the Irrigation Company received only bonds of the Water Company but no stock, the transaction did not come within the reorganization provisions of Section 112. (See certified copies of brief of the Collector on file with this Court in this cause.) The Circuit Court of Appeals, following the decisions of this Court, overruled this argument as well as the complaint concerning the motion for continuance.

That Court, however, proceeded to reverse the judgment of the District Court upon a ground that had never been raised by the respondent or argued before that Court or the District Court. For an understanding of that Court's action it is necessary to refer back to certain details of the reorganization.

The Irrigation Company and the Water Company and LeTulle on November 4, 1931, executed a plan for the reorganization of the Irrigation Company's properties. (R. 75-91.) It recited that the Irrigation Company was the "owner of certain pumping plants, intakes, pumps, machinery, canals, flumes," and other irrigation properties "and prior to the conveyance hereinafter called for to be executed by the Irrigation Company to the Water Company, will be the owner of certain other land and irrigation properties" and provided for all of the properties to be later conveyed to the Water Company by the Irrigation Company for \$50,000 in cash and \$750,000 in bonds. (R. 76-77.) These other properties were at that time owned by

petitioner. At no place in this contract did petitioner bind himself to convey those properties to the Irrigation Company. The obvious reasons of the Water Company having him join in the agreement was to bind him personally to require the Irrigation Company to fulfill the contract (R. 87, par. XV), to warrant personally the Irrigation Company's titles (R. 87, par. XIV), and to enable the Water Company to obtain the good will attaching to the properties by petitioner's agreeing not to engage in the same business. (R. 84, par. VIII.)

Thereafter on November 7 the stockholders (R. 93-98) and the directors (R. 98-105) ratified and approved the plan of reorganization of November 4, and directed the officers and directors to dissolve the Irrigation Company as soon as the properties were conveyed to the Water Company. At that meeting the stock of the Irrigation Company was increased by \$166,000, this stock being subscribed and paid for by petitioner by his conveying certain properties to the Irrigation Company, the record not showing of what those properties consisted.

On November 18, after the transfer on that day to the Water Company, the Board directed the officers to take such steps as might be necessary to dissolve the Irrigation Company immediately and to distribute all its assets in cancellation of its stock. (R. 105-109.)

The Circuit Court of Appeals on its own motion, in the last paragraph of its opinion (R. 287), stated that as to the properties owned by petitioner on November 4, this was a mere device resorted to by petitioner in

order to transfer his properties to the Water Company along with the other properties of the Irrigation Company, that he merely used the Irrigation Company as a conduit for passing the title and in substance this was a mere sale of his properties. That Court held that, therefore, only so much of the cash and bonds as represented the price paid for the properties owned by the Irrigation Company on November 4 was entitled to be protected from taxation and that as to the remainder the transaction was a taxable sale by petitioner. It remanded the case for further proceedings consistent with its opinion.

This defense was never raised by the respondent in the District Court, he having filed only a general demurrer and general denial (R. 18, 39), or in his brief in the Circuit Court of Appeals.

In due time petitioner filed his motion for rehearing on April 21, 1939 (R. 289), and prayed for oral argument on this point, but the Court on April 27, 1939, overruled the same. (R. 293.)

2.

Statement Disclosing Basis Upon Which It Is Contended This Court Has Jurisdiction.

Jurisdiction of this cause is conferred upon this Honorable Court by Judicial Code, Section 240, as amended; United States Code, Title 28, Section 347.

The judgment of the Circuit Court of Appeals was entered April 3, 1939 (R. 288), and petitioner's motion for rehearing overruled on April 27, 1939. (R. 293.)

Questions Presented.

1. As the respondent did not invoke at any time the ground upon which the Circuit Court of Appeals reversed the judgment of the District Court, did that Court have authority to consider the same? Petitioner contends that this was a matter of defense that the respondent was required to raise affirmatively.

2. Was the Circuit Court of Appeals authorized in holding as a matter of law that the alleged action of petitioner was such a device as deprived him of the benefits of Section 112? We contend that no device was resorted to, and that on the record in this case the conclusion of that Court were wholly unwarranted.

3. The Circuit Court of Appeals having reversed the judgment in favor of petitioner on a theory that had not been advanced by respondent in either court, did that Court err in remanding the case to the District Court with instructions that further proceedings be had in accordance with its final and conclusive holding that, as to the properties at one time held by petitioner, the transaction was a taxable sale, without allowing the petitioner the opportunity to establish before the District Court by other evidence additional facts to combat this new and unexpected theory? We contend that under the circumstances petitioner has not had his day in court in reference to this theory of the Circuit Court of Appeals and, if the case should be remanded to the District Court, petitioner should have the opportunity to rebut by evidence the inferences drawn by the Circuit Court of Appeals.

Reasons Relied on for the Allowance of the Writ.

The reasons relied on for the allowance of the writ are that the Circuit Court of Appeals has decided important questions of Federal law which have not been and should be settled by this Court, and that these questions have been decided in a way probably in conflict with the applicable decisions of this Court.

(1) The Circuit Court of Appeals held on its own motion that, where petitioner transferred certain irrigation properties of his own to the Irrigation Company for stock in that Company in a tax free transaction under Section 112(b)(5) of the Revenue Act of 1928, and the Irrigation Company thereafter exchanged all of its properties for cash and bonds of the Water Company in a tax free transaction under Section 112(b)(4), all in strict accordance and in conformity with the above provisions of Section 112, it had authority to hold, and did hold, without the point being raised by the respondent by defensive pleading, argument or otherwise, that petitioner resorted to this procedure as a scheme and device to avoid a tax upon himself that would have resulted if he had sold his individual properties directly to the Water Company. The transfer by petitioner to the Irrigation Company of these properties for stock in that Company and the transfer by the Irrigation Company of all the properties to the Water Company, were all in accordance with the provisions of Section 112 and under that section these were tax free transactions. If the respondent desired to attack them on the ground

that it was a scheme and a device, as held by the Circuit Court of Appeals, the burden was upon him to raise that issue as defensive matter in the trial court, and as he did not do so, the decision of the Circuit Court of Appeals in reversing the trial court on that ground on its own motion is probably in conflict with the decisions of this Court in *General Utilities & Operating Company v. Helvering*, 296 U. S. 200, and *Helvering v. Salvage*, 297 U. S. 106, 109, and of the Circuit Courts of Appeal in *Budd v. Commissioner of Internal Revenue*, 43 F. (2d) 509, *Marshall v. Commissioner*, 57 F. (2d) 633, 634, and *Commissioner v. Neaves*, 81 F. (2d) 947, 948-9.

(2) Even if the ground upon which the Circuit Court of Appeals reversed the judgment of the trial court had been pleaded or otherwise raised by the respondent, that Court improperly held as a matter of law that this was a mere scheme by petitioner to sell his individual properties, using the Irrigation Company merely as a conduit and thus to avoid taxation that would have resulted if he had sold his individual properties directly to the Water Company. The decision of that Court is probably in conflict with the decision of this Court in *General Utilities & Operating Company v. Helvering*, *supra*, where the Company deliberately distributed certain stock to its stockholders and brought about a sale of that stock by them in order to avoid a corporate tax, and in *Helvering v. Minnesota Tea Company*, 296 U. S. 378, where the Tea Company deliberately transferred part of its assets to a new corporation and distributed the

stock of that Company to its stockholders, in order that, when it sold its remaining assets, it could say that it disposed of substantially all of its assets in a tax free reorganization, and the decisions of the Circuit Courts of Appeals in *Helvering v. Winston Bros. Company*, 76 F. (2d) 381, 383, *Chisholm v. Commissioner*, 79 F. (2d) 14, and *Commissioner v. Freund*, 98 F. (2d) 201, 207. As will be more fully pointed out in the brief in support of this petition, there were valid business reasons for handling the transaction in this manner and, if petitioner's individual properties had been sold directly to the Water Company, the income taxes that petitioner would have paid would actually have been less than his income tax liability as determined by the trial court in this case. Under those circumstances the Circuit Court of Appeals was not justified in the conclusions that it drew.

(3) Even if the Circuit Court of Appeals had authority to consider the ground upon which it reversed the judgment of the trial court, then, since its action was based upon a theory that was not before the trial court and which petitioner has therefore never had an opportunity to combat by additional facts and evidence, the Circuit Court of Appeals erred in holding as a matter of law that as to petitioner's individual properties the transaction was a taxable sale and in reversing the case with instructions to the trial court merely to proceed in conformity with its opinion. As will appear more fully from the brief in support of this petition, there were justifiable business reasons for the transfer of those properties to the Irrigation

Company and to support which the petitioner would have introduced evidence in the trial court if he had known that such a claim would be made. Under such circumstances the petitioner would be entitled on a new trial to present these additional facts under the decision of this Court in *Helvering v. Gowran*, 302 U. S. 238, and the Circuit Court of Appeals' decision in that respect is probably in conflict with said decision of this Court.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari may issue out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Fifth Circuit commanding said Court to certify and send to this Court on a day certain, to be therein designated, a full and complete transcript of the record of all of the proceedings in the Circuit Court of Appeals in said cause entitled *Frank Scofield, United States Collector of Internal Revenue for the First District of Texas, Appellant, v. V. L. LeTulle, Appellee*, No. 8948 on its docket, to the end that said cause may be reviewed and determined by this Court as provided by Section 240 of the Judicial Code, as amended, and that your petitioner may have such other and further relief or remedy in the premises as this Court may deem appropriate and in conformity with said provisions of the Judicial Code, and that on hearing be-

fore this Honorable Court said judgment of the Circuit Court of Appeals be reversed by this Honorable Court and such relief granted as is appropriate to the cause.

V. L. LeTULLE,

By W. E. DAVANT,

HOMER L. BRUCE,

Attorneys for Petitioner.

No.

IN THE
Supreme Court of the United States

OCTOBER TERM, 1938.

V. L. LETULLE, *Petitioner*,

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF
INTERNAL REVENUE FOR THE FIRST DISTRICT
OF TEXAS, *Respondent*.

BRIEF IN SUPPORT OF PETITION FOR
WRIT OF CERTIORARI

I.

The Opinions of the Courts Below.

The District Court wrote no opinion but its findings of fact and conclusions of law are found at page 192 of the Record. The opinion of the Circuit Court of Appeals has not been reported but is found at page 283 of the Record.

II.

Jurisdiction.

Stated under heading 2 of the petition.

III.

Statement of the Case.

A full statement of the case has been given under heading 3 in the petition and in the interest of brevity is not repeated.

IV.

The Law.

The applicable provisions of the statutes are set out in Appendix A.

V.

Specification of Errors.

1. As respondent at no time raised as a defense by pleadings, evidence, argument or otherwise the grounds upon which the Circuit Court of Appeals reversed the judgment of the District Court, the Circuit Court of Appeals erred in considering them and in reversing the judgment of the District Court thereon.

2. The Circuit Court of Appeals erred in reversing the judgment of the District Court on the grounds set forth in its opinion, because the burden of pleading and proving those grounds as a defense to petitioner's suits was upon respondent and he at no time pleaded the same as a defense or offered any evidence in support thereof or in any manner interposed the same as a defense.

3. The Circuit Court of Appeals erred in holding

that the burden was upon petitioner to show not only that he had been illegally taxed but how much of what was collected from him was illegal and that he had failed to discharge this burden, because, having shown that the transactions involved came within the tax free reorganization provisions of Section 112 of the Revenue Act of 1928, the burden was upon respondent to plead and prove in the trial court that petitioner, as to the properties at one time owned by him, used the Gulf Coast Irrigation Company as a conduit to escape taxation and to plead and prove the other grounds upon which said Court reversed said judgment, and he did not plead, prove or in any way rely thereon as a defense.

4. The Circuit Court of Appeals erred in holding that, in so far as the properties transferred by petitioner to the Irrigation Company were concerned, the transaction was a sale by petitioner and that only so much of the consideration as represented the price of the other properties was entitled to be protected from taxation as arising from a reorganization.

5. The Circuit Court of Appeals erred in remanding the case to the District Court for further proceedings in conformity with its opinion without affording petitioner the opportunity to establish before the District Court by other evidence additional facts to disprove the theory upon which the Circuit Court of Appeals reversed said judgment.

ARGUMENT**Summary of the Argument.****Point A.**

Petitioner in no way used the Irrigation Company as a conduit to avoid a taxable sale of his properties to the Water Company.

Point B.

The Circuit Court of Appeals had no authority to consider the grounds upon which it reversed the judgment of the trial court.

Point C.

Even if the Circuit Court of Appeals was authorized to remand the case to the trial court, it should have allowed petitioner to introduce such pertinent evidence as he might desire to rebut the conclusions on which the Circuit Court of Appeals reversed the judgment.

Points A and B

As these points involve so many related factors, they will be discussed together.

On November 4, 1931, the Irrigation Company owned pumping plants and a general irrigation system. Operated in connection therewith were certain other canals and lands which petitioner, the owner of all the stock of that Company, had never actually transferred to it. The Water Company desired to acquire the whole as an integral unit, but, as the Circuit Court of Appeals pointed out, had no independent resources with which to buy them or to pay off

the bonds that it gave as part of the purchase price. If the properties were profitable in their operation, the bonds would be paid off, otherwise the Irrigation Company and petitioner through it would have to take them back. The Irrigation Company, and on its dissolution the petitioner, received \$50,000 in cash and \$750,000 in bonds for these properties. The Commissioner held that this was a taxable sale, that the Irrigation Company received a taxable profit of \$301,124.04 (R. 11), and that petitioner received on the liquidation of that Company a taxable profit of \$473,209.49. (R. 22). Yet, all of this profit was only a paper profit, represented by these \$750,000 of bonds, which as the lower court pointed out might never be paid off at all. But on this paper profit petitioner, individually and as a transferee of the Irrigation Company, was forced to pay a tax of \$110,234.00 (R. 59), that being the overpayment for which the District Court gave him judgment.

Now, if petitioner had known in November, 1931, that he would on March 15, 1932, owe the Federal Government an income tax of \$110,000 while still holding merely bonds of the character involved, it is obvious that the trade probably would not have been consummated. On the other hand, if the bonds should be paid off as they matured and his paper profit thereby converted into actual cash, then petitioner would be able and entirely willing to pay the appropriate income taxes each year on that part of the profit actually realized by him. That is exactly the attitude that Congress has for many years taken in regard to

such paper profit transactions through the tax free reorganization and installment sales provisions of the various revenue acts. For the purpose of enabling parties to make such purchases, sales, and exchanges of properties, it has long provided that the tax shall be payable only when the paper profit has been converted into cash, and the reorganization and installment sales provisions are in no sense loopholes for the evasion of taxes.

As stated, on November 4, 1931, the Water Company desired to purchase this irrigation system, the bulk of which was owned by the Irrigation Company and the balance by petitioner individually. There were any number of ways by which petitioner could have turned the transaction, and as will be later demonstrated, he could have so arranged it that he would have paid less taxes than he has actually paid. But there was one controlling factor making it imperative that the whole properties be transferred to the Water Company in one deed and that all the properties be security for each and every one of the bonds representing the purchase price. As the lower court pointed out, the Water Company had no resources other than these properties, and if it did not prosper, "the seller would most likely only get its property back."

Under the law of Texas, if the vendor of real property takes a mortgage or deed of trust back from the vendee to secure the unpaid purchase price, as was done in this case (R. 110-113, 113-177), the superior right to the land remains in the vendor until all of the purchase price has been paid. If default is made by

the purchaser, the vendor may either sue to foreclose his lien or may rescind the sale and take immediate possession of the property. *Dunlap v. Wright*, 11 Tex. 597; *Burgess v. Millican*, 50 Tex. 397; *Kennedy v. Embry*, 72 Tex. 387; *Crafts v. Daugherty*, 69 Tex. 477; *Jackson v. Palmer*, 52 Tex. 427. Under these circumstances, if all the properties were transferred to the Water Company by one deed, as was done in this case, all the properties would be subject to this vendor's lien to secure all the bonds and upon default in payment of any of the bonds, petitioner could rescind and take possession of all the properties as an operating unit and not be required to go through the delay of a foreclosure.

If, on the other hand, petitioner had done what the Circuit Court of Appeals held him to have done, that is, sold his individual properties directly to the Water Company for part of the bonds and had the Irrigation Company transfer the other properties for the remainder of the bonds, then part of the bonds would have been secured by a vendor's lien on one part of the properties and the other bonds secured by a vendor's lien on the other part, and even though a mortgage should be given upon all the properties as a unit to secure all the bonds, nevertheless, this right of rescission would have been materially impaired. In order for that right to have been preserved at all, it would have been necessary to designate which bonds were issued for the Irrigation Company's properties and which for petitioner's so-called individual properties. If the Water Company should keep current its payments, for example, on the bonds issued for the Irriga-

tion Company's properties, but default should be made as to the other bonds, petitioner's right of rescission as to the Irrigation Company's properties would not exist. On the other hand, where, as was done here, all the properties were transferred by one deed and all the bonds represented unpaid purchase money on all the properties, then if default were made in the payment of the bonds, petitioner could rescind as to the whole properties and retake possession without the necessity of a foreclosure.

Under the contract of November 4th, the Irrigation Company recited that it would own certain other properties prior to the contemplated conveyance by it to the Water Company, but nothing is said in that contract as to how the Irrigation Company should obtain them, and petitioner does not in any way rely upon that agreement as a reorganization of petitioner's interest in his individual properties, as the Circuit Court of Appeals in its opinion seems to indicate.

There were a number of ways in which petitioner could have transferred the properties to the Irrigation Company or have sold them directly to the Water Company and he would have incurred no greater tax liability than he did under the method actually employed. What he actually did, in order that the properties might all be transferred to the Water Company by one deed and be secured as a whole by one vendor's lien, was to transfer his properties to the Irrigation Company in payment of additional stock of that company, all of whose stock he owned. This was done in accordance with Section 112(b) (5) of the 1928 Revenue Act (Appendix A of this brief), and was a trans-

action in which neither gain nor loss under that section is recognized, and the Government has all the way through treated that transfer as a non-taxable transaction.

Petitioner could have accomplished the same results without increasing his income tax liability in any manner. He could have sold the properties to the Irrigation Company for cash or for notes at his exact cost and he would have had no tax to pay. He also could have done exactly what the Circuit Court of Appeals said he should have done, that is, sold these individual properties directly to the Water Company for part of the bonds and could have returned his profit on that sale on an installment basis under Section 44(b) of the 1928 Revenue Act, and paid his income tax as to that sale on an installment basis only as and when he collected the bonds. He could have had the first maturing bonds taken by the Irrigation Company and the later maturing bonds given for his own properties. Under that arrangement for the year 1931, the year involved, his income tax liability would have been actually less than his income tax for that year as determined by the District Court, and in which he has acquiesced. As the recomputation of his tax liability for 1931 is rather complicated, we respectfully refer this Honorable Court to Appendix B of this brief, from which it will be seen that for 1931, if petitioner had done what the Circuit Court of Appeals said he should have done, his tax liability would have been materially decreased. What his tax liability would have been during the succeeding years, neither the Circuit Court of Appeals nor anyone else can say, for that would depend

upon so many unknown factors, whether the bonds would be paid off, what other income or losses he might have from other business, and a variety of others.

It is clear, therefore, that the Circuit Court of Appeals was not in any way justified in holding that petitioner used the Irrigation Company as a conduit to avoid a taxable sale and therefore reversing the trial court's judgment.

But even without the foregoing considerations, the decision of the Circuit Court of Appeals is in conflict with those of this Court in *General Utilities & Operating Company v. Helvering*, 296 U. S. 200, and other cases. There the Southern Cities Utilities Company approached the General Utilities Company to buy from the latter stock that it owned in Islands Edison Company, but General Utilities Company refused to sell solely because of the resulting tax upon it. For the sole purpose of avoiding this tax, it proposed to distribute the stock to its stockholders and have the Southern Company buy it from them. The two companies thereupon worked out the terms upon which the Southern Company would buy from the stockholders and the plan was consummated. As against the affirmative contention of the Commissioner that this was a scheme to avoid the corporate tax (pages 29 to 38 of his brief in this Court), this Court upheld the transaction. Again, in *Helvering v. Minnesota Tea Company*, 296 U. S. 378, the Tea Company had an opportunity to sell part of its assets for cash and stock, but, for this to partake of a tax free reorganization as to the stock, the transfer must be of substantially all of the assets of the Tea Company. To meet this re-

quirement, that Company first transferred all its other assets to a newly organized subsidiary for all of its stock, which it immediately distributed to its stockholders. It thereupon concluded the originally contemplated sale of all its remaining assets and came within the statutory requirement of "substantially all of its properties." [See dissenting opinion of Judge Woodrough, 76 Fed. (2d) 797, at 803.] Nevertheless, this whole transaction was approved.

Petitioner merely followed the exact provisions of the Revenue Act, and even if he had thus reduced his income tax liability, the respondent would have no ground of complaint, for as this Court said in *Gregory v. Helvering*, 293 U. S. 469:

"The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted. *United States v. Isham*, 17 Wall. 496, 506; *Superior Oil Co. v. Mississippi*, 280 U. S. 390, 395-6; *Jones v. Helvering*, 71 F. (2d) 214, 217."

Although the lower court did not cite the *Gregory case*, it apparently attempted to bring the present one within the exceptional facts involved in that case, but as was pointed out in the *Minnesota Tea Company case* at page 385 of 296 U. S., the *Gregory case* revealed a mere sham, whereas the record in the *Tea Company case* suggested nothing other than a bona fide business move, and we respectfully submit that the same is true in this case.

That the doctrine of the *Gregory case* will be ap-

plied only in clear cases is illustrated by *Helvering v. Winston Bros. Company*, 76 Fed. (2d) 381, 383; *Chisholm v. Commissioner*, 79 Fed. (2d) 14; and *Commissioner v. Freund*, 98 Fed. (2d) 201, 207, and the decision of the Circuit Court of Appeals is in conflict also with the decisions in those cases.

But, under the record, the Circuit Court of Appeals was not authorized to consider this point. We will review briefly the objections raised by the Government throughout this controversy. As shown on pages 66, 68, 70 and 74 of the record, petitioner introduced in evidence the original income tax returns, the letters from the Commissioner setting forth the ground on which he assessed the additional taxes and petitioner's claims for refund. All of these were before the trial court, but, since the respondent pleaded only a general demurrer and general denial (R. 18, 39) and the Commissioner and the respondent at no time contested petitioner's claims except on the one ground that no tax free reorganization resulted solely because the Irrigation Company obtained no stock in the Water Company, all of these documents were omitted from the record by the attorneys as they would serve no useful purpose on the appeal. However, those letters and instruments disclosed to the trial court, and would to this Court if in the record, that the Commissioner at no time from the original field audit of the returns in 1932 through the trial of the case, relied on anything except the above mentioned point. The trial court overruled it, and in the Circuit Court of Appeals, as shown by certified copies

of respondent's briefs in that Court which we have filed in this case for this Court's information, he again raised only the one answer to petitioner's claim. Yet the Circuit Court of Appeals, after overruling every contention of the respondent, *sua sponte* reversed and remanded the case and refused to allow petitioner the opportunity of any oral argument although in his motion for rehearing he respectfully requested that privilege. This action by the lower court was contrary to the fair standard reiterated by this Court in the *General Utilities & Operating Company case, supra*, at page 206 of 296 U. S.:

"Always a taxpayer is entitled to know with fair certainty the basis of the claim against him."

In that case, the Commissioner appealed to the Circuit Court of Appeals on one ground but, as shown by 74 Fed. (2d) 972, actually raised in his brief the additional point upon which the Circuit Court of Appeals reversed the Board of Tax Appeals, that is, that there was a mere scheme to avoid taxation. In the present case respondent did not even inject the point into the case at all. Yet this Court in the *General Utilities case* properly held that the Circuit Court of Appeals erred in even considering the Commissioner's argument. We fail to see how the two decisions can be reconciled.

We submit that, where petitioner showed that he and the Irrigation Company had complied with the requirements of Section 112 of the Revenue Act, if the Government desired to resist his claim on the

ground that he had resorted to the alleged scheme, the burden was upon the Government to plead and prove that as an affirmative defense, and the decision of the lower court is in conflict with the decisions in the *General Utilities Company case*, *supra*, and in *Helvering v. Salvage*, 297 U. S. 106, 109; *Budd v. Commissioner of Internal Revenue*, 43 F. (2d) 509, 512; *Marshall v. Commissioner*, 57 Fed. (2d) 633, 634; *Commissioner v. Neaves*, 81 Fed. (2d) 947, 948-9, and many others. It is so well established that, where a plaintiff establishes a legal right, if the defendant relies as a defense upon fraud, devices or scheming, the burden is upon him affirmatively to plead and prove the same, that further citations are unnecessary.

Point C

The Circuit Court of Appeals held as a matter of law that, in so far as petitioner's individual properties were concerned, it was the same as if he had sold them to the Water Company, and if he desired to avail himself of Section 112 as to the Irrigation Company properties, the burden was upon him to show how much was paid for them and this he had failed to do, and remanded the case "that further proceedings may be had consistent with the opinion of this Court." As we construe that Court's order, the petitioner will on a new trial be conclusively bound by the opinion of the Circuit Court of Appeals and will not be allowed to introduce any evidence to overcome that Court's conclusions. The only factor that will be left in the case will be the determination of how much of

the \$50,000 in cash and \$750,000 in bonds were paid for the Irrigation Company's properties and for those of petitioner. If that can be determined, then the Circuit Court of Appeals admits that as to the Irrigation Company properties petitioner's taxes are to be computed on a tax free basis under Section 112. But if he fails to show that apportionment, then he will be entitled to no recovery whatsoever and the Government will keep the \$110,000 of taxes that the District Court found had been illegally collected.

Without in any way being considered bound by judicial estoppel, we nevertheless frankly admit that up to this moment we have been unable to determine how petitioner could meet this impossible burden. All the properties were sold as a unit for the cash and bonds, and how any apportionment under the lower court's rule can be made we are at a loss at present to know. If that situation exists on the new trial, then petitioner will recover nothing. Petitioner will thus never have had his day in court upon the theory on which he will have lost out entirely.

Since the case was thus reversed on a theory developed by the Circuit Court of Appeals *sua sponte* and to the complete surprise of petitioner, its decision is in conflict with that of this Court in *Helvering v. Gowran*, 302 U. S. 238, where this Court held the proper practice under similar circumstances is for the case to be remanded, but with the opportunity afforded petitioner to establish before the trial court additional facts which would affect the result.

Conclusion.

It is respectfully submitted that this case is such as to call for the exercise by this Court of its supervisory powers, and we, therefore, respectfully pray that the petition for writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit be granted.

W. E. DAVANT,
HOMER L. BRUCE,
Attorneys for Petitioner.

APPENDIX A

REVENUE ACT OF 1928, CH. 852, 45 STAT. 791

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in Personal Property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of Realty and Casual Sales of Personal Property.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding \$1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—
* * * * *

(3) **STOCK FOR STOCK ON REORGANIZATION.**—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) **SAME—GAIN OF CORPORATION.**—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) **TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.**—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by

each is substantially in proportion to his interest in the property prior to the exchange.

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to

be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115.—

(1) The term, “reorganization” means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

APPENDIX

This exhibit is in support of the statement on page 20 of the brief that, if petitioner had sold his individual properties directly to the Water Company, as the Circuit Court of Appeals held he did, he would have actually paid less income taxes in 1931 than the trial court found to be due.

Petitioner could have sold his properties to the Water Company for a small amount of cash and the remainder in the last maturing of the \$750,000 of bonds. He would then have had the right under Section 44(b) of the 1928 Revenue Act to report his profit only as the bonds were paid from year to year. By taking only the later maturing bonds, he would have collected nothing on them in 1931 on account of his personal properties.

Since the properties were exchanged as a whole for \$750,000 of bonds, it is impossible to say for how much he would have sold his individual properties, but typical examples may readily be taken.

On the appended table, the separate computations are as follows:

1. Column I is a reprint of the computation of his profit on the liquidation of the Irrigation Company and of his income taxes as made by the trial court (R. 197-199) showing a tax liability of \$8,127.18 for himself of \$16,254.36 for himself and wife.

2. Column II is on the basis of the Irrigation Company taking \$281,954.89 of bonds and he in-

dividually, \$468,045.11. This shows a tax liability of \$6,231.83 or \$12,463.66 for himself and wife, or \$3,790.70 *less than the trial court found.*

3. Column III is on the basis of the Irrigation Company taking \$500,000 of bonds and he individually, \$250,000. This shows a tax liability of \$7,268.81 or \$14,537.62 for himself and wife, or \$1,716.74 *less than the trial court found.*

4. Column IV is on the basis of the Irrigation Company taking \$600,000 of bonds and he individually \$150,000. This shows a tax liability of \$7,534.13 or \$15,068.26 for himself and wife, or \$1,186.10 *less than the trial court found.*

We make the following explanations in connection with these computations:

1. On page 196 of the record the trial court set out the cost of the original 1,000 shares he had held for more than two years and of the 1,660 shares he obtained in November, 1931, and apportioned to them as additional cost the liabilities of the Irrigation Company that he became responsible for when all of its assets were distributed to him. If he had sold his properties directly to the Water Company, he would have had only the 1,000 shares and all of these liabilities would have been added as part of the cost of those shares, and corresponding changes have to be made in the computations.

2. Since he would have held only the 1,000 shares, his profit on the liquidation of the Irrigation Company would have been subject to the lower capital gain rate.

3. The profit realized on the payment of bond 1 to 8 in 1931 varies in each column, depending on the varying cost basis per \$1,000 of bonds. Compare allocation and determination of cost basis by trial court on page 196 of Record.

4. In Column II the assumed allocation of bond between the Irrigation Company and petitioner is the same as the trial court's allocation on page 196 of the Record as between the 1,000 shares petitioner owned and the 1,660 shares he received for his individual properties. This is clearly disproportionate and for that reason the examples in Columns III and IV are set out. We believe that allocating as in Column IV, \$600,000 of bonds to the Irrigation Company properties and only \$150,000 to his individual properties is going too far the other way and allocating too small an amount of bonds to his properties. But even there, it shows a smaller tax liability than the trial court has found and to which petitioner has acquiesced.

On the succeeding page are the computations.

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PROFIT ON LIQUIDATION OF GULF COAST IRRIGATION COMPANY

Consideration received:

	I		II		III		IV	
(a) Bonds:								
\$150,000 at face value.....		\$150,000.00	\$150,000.00 at face value.....	\$150,000.00	\$150,000.00 at face value.....	\$150,000.00	\$150,000.00 at face value.....	\$150,000.00
\$600,000 at 75% of face value.....		450,000.00	131,954.89 at 75% of face value, 98,966.17		350,000.00 at 75% of face value.....	262,500.00	450,000.00 at 75% of face value.....	337,500.00
(b) Cash and property:								
A. Reported as ordinary dividend.....	\$15,339.78		\$15,339.78		\$15,339.78		\$15,339.78	
B. Cash (net).....	42,950.43		42,950.43		42,950.43		42,950.43	
C. Notes receivable.....	33,421.96		33,421.96		33,421.96		33,421.96	
D. Real Estate.....	3,050.00	94,762.17	3,050.00	\$94,762.17	3,050.00	\$94,762.17	3,050.00	\$94,762.17
TOTAL.....		694,762.17		\$343,728.34		\$507,262.17		\$582,262.17
Less liabilities:								
E. Accounts payable.....	\$55,000.00		\$55,000.00		\$55,000.00		\$55,000.00	
F. Ad valorem taxes in dispute.....	6,787.85		6,787.85		6,787.85		6,787.85	
G. Bryan Jackson account.....	13,547.86		13,547.86		13,547.86		13,547.86	
H. Revenue stamps.....	375.26		375.26		375.26		375.26	
J. Income taxes of Gulf Coast Irrigation Co.....	7,963.07		7,963.07		7,963.07		7,963.07	
K. Commissions.....	40,000.00	\$123,674.04	40,000.00	\$123,674.04	40,000.00	\$123,674.04	40,000.00	\$123,674.04
NET AMOUNT RECEIVED.....		\$571,088.13		\$220,054.30		\$383,588.13		\$458,588.13
Cost of stock in Gulf Coast Irrigation Co. (2660 shares).....		\$187,945.03	(1000 shares)	\$58,407.12		58,407.12		58,407.12
PROFIT.....		\$383,143.10		\$161,647.18		\$325,181.01		\$400,181.01
TAXABLE PROFIT.....		94,762.17		94,762.17		94,762.17		94,762.17
Taxable profit allocated to 1660 shares held less than two years.....		59,137.30						
Taxable profit allocated to 1000 shares held over two years (capital gain).....		35,624.87		94,762.17		94,762.17		94,762.17
COMPUTATION OF TAX								
Net income per return.....		82,296.38		82,296.38		82,296.38		82,296.38
Deduct (as included in return and included below):								
(1) Profit on liquidation of Gulf Coast Irrigation Company.....	\$76,358.40		76,358.40		76,358.40		76,358.40	
(2) Dividend reported as ordinary income (part of liquidating distribution).....	15,339.78	\$91,698.18	15,339.78	91,698.18	15,339.78	91,698.18	15,339.78	91,698.18
DEFICIT.....		\$9,401.80		\$9,401.80		\$9,401.80		\$9,401.80
Add:								
(3) Reduction in loss on ranch.....	\$3,245.00		3,245.00		3,245.00		3,245.00	
(4) Reduction in interest.....	6,906.17		6,906.17		6,906.17		6,906.17	
(5) Bad debts disallowed.....	1,773.73		1,773.73		1,773.73		1,773.73	
(6) Profit on liquidation of Gulf Coast Irrigation Company:								
Capital gain.....	35,624.87		94,762.17		94,762.17		94,762.17	
Ordinary income.....	59,137.30							
(7) Profit on payment in 1931 of Bonds 1 to 7:								
Amount received.....	\$70,000.00		70,000.00		70,000.00		70,000.00	
Cost basis.....	26,045.53	43,954.47	45,204.60	24,795.40	25,491.20	44,508.80	21,452.90	48,547.10
(8) Profit on payment in 1931 of Bond 8:								
Amount received.....	\$6,648.30		\$6,648.30		\$6,648.30		\$6,648.30	
Cost basis.....	2,473.69	4,174.61	4,293.34	2,354.96	2,421.04	4,227.26	2,037.50	4,610.80
Taxable income on community basis.....		\$145,414.35		\$124,435.63		\$146,021.33		\$150,443.17
One-half to each spouse.....		72,707.18		62,217.82		73,010.67		75,221.59
Less capital gain (1/2 of \$35,624.87).....		17,812.43	(1/2 of \$94,762.17)	47,381.09		47,381.09		47,381.09
Balance available at ordinary rates.....		\$54,894.75		\$14,836.73		\$25,629.58		\$27,840.50
Less:								
Dividends.....	\$2,672.50		\$2,672.50		\$2,672.50		\$2,672.50	
Personal exemption and credit for dependents.....	2,150.00	4,822.50	2,150.00	4,822.50	2,150.00	4,822.50	2,150.00	4,822.50
Balance subject to normal tax.....		\$50,072.25		\$10,014.23		\$20,807.08		\$23,018.00
Normal tax 1 1/2% on \$4000.00.....		60.00		60.00		60.00		60.00
Normal tax 3% on \$4000.00.....		120.00		120.00		120.00		120.00
Normal tax 5% on \$42,072.45.....		2,103.61	(On \$2,014.23)	100.71	(On \$12,807.08)	640.35	(On \$15,018.00)	750.90
Surtax on \$54,894.75.....		3,645.27	(On \$14,836.73)	56.73	(On \$25,629.58)	554.07	(On \$27,840.50)	708.84
Tax at 12 1/2% on \$17,812.43.....		2,226.55	(On \$47,381.09)	5,922.64	(On \$47,381.09)	5,922.64	(On \$47,381.09)	5,922.64
TOTAL.....		\$8,155.43		\$6,260.08		\$7,297.06		\$7,562.38
Earned income credit.....		28.25		28.25		28.25		28.25
Income tax liability.....		\$8,127.18		\$6,231.83		\$7,268.81		\$7,534.13

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1939

V. L. LETULLE, *Petitioner,*

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS

ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES CIRCUIT COURT OF
APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF OF PETITIONER

W. E. DAVANT,
HOMER L. BRUCE,
Attorneys for Petitioner.

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REPLY BRIEF OF PETITIONER

We desire to file this brief reply to the brief in opposition by the respondent because of what we feel are many inaccurate statements by respondent as to the record and inferences to be drawn therefrom. If respondent's brief alone is read without any explanation, an entirely erroneous view of petitioner and his complaint unfortunately will readily be obtained.

At the outset we call attention to the status in this record of respondent's motions for continuance and for a new trial and the many exhibits attached thereto. These motions were overruled by the trial court, and, when respondent appealed to the Circuit

Court of Appeals, that court overruled his assignments of error on that point. They were in the record solely because of his exceptions to the trial court's action. Now that he has acquiesced in their being overruled by not appealing to this Court, they have no material place in the record and may in no way be relied upon by respondent. Yet he devotes two pages of his statement detailing their contents (Brief, pages 6 to 8), and relies in his argument upon inferences to be drawn from them and their ex parte statements, and thereby builds up a very unfavorable picture of petitioner.

Likewise, as will be further pointed out later, respondent by inference attempts to use these motions to supplement his answer and cure his failure to plead the defense that he was required to plead affirmatively.

The transaction involved was simple and had none of the earmarks of "sham or subterfuge" that respondent asserts.

The case was simply as follows, both actually and as borne out by the entire record, including respondent's motions. Petitioner owned all the stock of the Gulf Coast Irrigation Company and also some irrigation properties personally. Gulf Coast Irrigation Company and Gulf Coast Water Company entered into a plan of reorganization of November 4, 1931, under which the Irrigation Company agreed that it would, after obtaining title to all the properties, transfer them to the Water Company for cash and bonds. Petitioner joined in the agreement not for the purpose of selling his own prop-

erties, but for his individual agreements to warrant personally the titles and similar collateral agreements on his part. Petitioner transferred his properties to the Irrigation Company for stock and thereafter the Irrigation Company transferred the properties to the Water Company for cash and bonds. It immediately dissolved and distributed all its assets to petitioner in cancellation of its stock. The government ruled that the bonds were not securities and therefore the transfer was a taxable sale and the distribution to petitioner was taxable. It accordingly assessed a corporation tax against petitioner as transferee of the Irrigation Company and an individual tax on him personally. Petitioner sued to recover on the ground that as to the bonds both the transfer and distribution were tax free. The respondent pleaded only a general demurrer and general denial and contested petitioner's claim in both lower courts on the sole ground that bonds are not securities within the tax free reorganization sections. The Circuit Court held they were securities and overruled all of respondent's contentions, but on its own motion held the transfer by petitioner of his properties to the Irrigation Company was a device to evade taxes and as to those properties it would disregard the Irrigation Company and treat them as being sold directly by petitioner to the Water Company.

Respondent's version of the facts as set out in his statement is as follows: Prior to the above mentioned agreement on which the transfer was closed, the Irrigation Company and petitioner had made

a contract with Continental Service Company under which the Irrigation Company and petitioner each sold their separate properties to the Continental Service Company, that the corporate minutes showed this sale to have been kept alive and the final transfer was closed on that contract, and the agreement of November 4, 1931, on which petitioner relies, was entered into merely for the purpose of calling the transaction a reorganization for the sole and exclusive purpose of attempting to evade taxes. He then states petitioner had disposed of his own properties by this outright sale. His statement then concludes (Brief p. 8):

"The Circuit Court of Appeals did not regard the denial of the Government's motions as error, but instead, *on the basis of the facts established by the evidence in the record*, reversed the judgment of the trial court insofar as it had applied the reorganization provisions to the properties individually owned by the taxpayer at the time the contract was entered into." (Italics ours.)

This statement occurring, as it does, immediately after respondent's detailed analysis of its motions, it seems to us that respondent's position is that the Circuit Court of Appeals based its action not only on the actual evidence but also upon that contained in respondent's motions. If such is the case, then of course it was palpable error for the lower court in any way to consider those motions.

It seems to us that respondent at least is attempting to give this Court the view that the actual

transaction was not as shown by the admitted evidence, and thus place petitioner in as unfavorable a light as possible.

The following were the facts concerning the prior contract as shown by the evidence and respondent's motions, the motions for this purpose being taken as true.

As respondent states on pages 6 and 7, petitioner testified that he had a prior contract for the sale of these properties. Respondent then states that the corporate minutes showed that the prior contract was kept alive and the final contract was made for tax evasion purposes. The history of the prior contract, as set out by respondent's motions, was as follows:

On November 5, 1930, petitioner and the Irrigation Company made a contract with B. E. Buckman and Company under which they agreed to convey or cause to be conveyed certain properties "now owned by Gulf Coast Irrigation Company" (R. 217) for \$200,000 *in cash* (R. 221) upon approval of titles and \$600,000 in notes maturing over a period of twelve years. This contract and other properties were transferred on December 16, 1930, to Continental Public Service Company (R. 238). That Company on January 21, 1931, transferred the contract to Central West Water and Power Company for \$500,062.50, represented by the latter's note, that Company assuming the obligation to pay Gulf Coast Irrigation Company the \$800,000 (R. 240). In September, 1931, Central West Water and Power Company transferred the contract to Gulf

Coast Water Company, which assumed the \$800,000 obligation and gave the Central Company its note for \$525,062.50 (R. 242).

It will be noted that the corporate minutes respondent refers to are those of only Gulf Coast Water Company and its predecessors in title and its apparently associated companies. There is not one scintilla of evidence that petitioner knew anything about those minutes or had any connection with those intercompany transactions. The truth of the whole situation is obvious. Buckman and Company transferred the contract to Continental Public Service Company for a large amount of that company's stock (R. 238). That Company transferred it for \$500,062.50 to Central West Water and Power Company (R. 241), which in turn transferred it for \$525,062.50 to Gulf Coast Water Company (R. 242). When those companies failed to carry it out and it was cancelled and a new contract had to be made, they for their own corporate purposes had to give support to the more than \$500,000 they paid each other for the contract and so built up their intercorporate records in this manner. But, as stated above, petitioner had nothing to do with any of those wholly unilateral transactions.

The truth is Gulf Coast Water Company could not carry out the first contract and both petitioner and E. J. Crofoot, President of Gulf Coast Water Company, both testified that the old contract was wholly done away with and the new one of November 4, 1931, was executed, but respondent has wholly

failed to mention that fact to this Honorable Court.
 Petitioner testified (R. 178):

"We had that contract; Mr. Davant drew it up. It was with the Continental Service Company. That was before this contract here was made and they were not able to carry it out and then we wrote up another contract and that is the contract the deal was closed on. I do not know who the other contract was by name, whether it was the Continental Public Service or Mr. Crofoot or who made that, but Mr. Davant can state and explain all that to you; if you want to know anything about it, he has been my attorney for a long time. I received a payment of \$10.00 on that contract of January, 1931; and gave it back to them when we entered into the other contract. I would not swear to the date of the contract, some time in 1931; I do not know whether it was in the early part or not; the records will show when it was, I do not remember. I did not receive anything on the first contract; there was no contract made entirely because they were not able to carry out the first contract, at least they did not do it, but I don't know why. I do not know why they didn't go on with the contract; we tore up that contract and wrote another one. I received payment in bonds on this contract here; that Mr. Bruce had a while ago."

E. J. Crofoot testified:

"I heard the testimony and know of this transaction in November, 1931, whereby the Gulf Coast Irrigation Company transferred its assets to the Gulf Coast Water Company. At that time I was connected with the Gulf Coast Water Company; I was the President of the Company; I attended to the issuance of the

bonds at the time (R. 179). * * *

"I heard the testimony of Mr. LeTulle that he entered into a contract with the Continental Public Service Company in 1930, that is between the Gulf Coast Irrigation Company and the Public Service Company, but I do not remember that particular contract. I do not remember that contract at all. There was a contract between B. E. Beckmann & Company and the Gulf Coast Irrigation Company; my recollection is that was in December, 1930, some time (R. 180)."

"With reference to the contract Mr. Gibson was talking about, this old contract in 1931, this final contract did away with all prior contracts that we had. It is correct that the old contract was thrown away and we went into an entirely new and different contract altogether (R. 181)."

In the face of this positive and unequivocal testimony of the Presidents of both companies involved, respondent's brief is replete with inferences, insinuations and arguments that really the old contract was always in effect and actually petitioner sold his individual properties directly to the Water Company and in substance the holding of the Circuit Court of Appeals was in fairness and in equity correct.

There was a very concrete reason why the Water Company could not carry out the first contract. It called for the payment by the Water Company of \$200,000 in cash upon the closing of the purchase and \$50,000 a year for twelve years (R. 221). The final contract of November 4, 1931, called for only \$50,000 in cash and \$750,000 in bonds over a period

running to January 1, 1944, the first bonds maturing January 1, 1933, approximately fourteen months after the contract (R. 77). As the Circuit Court of Appeals pointed out (R. 286), the Water Company had no independent financial strength and, if the properties were successful, it could pay the bonds, otherwise not. Under these circumstances, it was a far different story for the parties backing the Water Company to risk only \$50,000 in cash rather than \$200,000.

Running all through respondent's brief is the inference that petitioner never transferred his properties to the Irrigation Company but that they passed directly from him to the Water Company.

On page 14 petitioner states that under the original contract petitioner "was to acquire the property owned by the old corporation and to transfer it along with his own property in an outright sale." He then states on page 15 that after the final contract was signed "a deed was executed by the corporation and by the taxpayer individually transferring the properties so combined to the new corporation. The record fails to show any transfer of the property from the taxpayer to the Irrigation Company." Respondent harps on this last statement of no transfer of petitioner's properties to the Irrigation Company. See his brief, pages 6, 10, 13 and 15. He even questions the existence of any such transfer in his statement of the question presented (Brief p. 2).

The true facts are as follows: The original contract with B. E. Buckman and Company, as pre-

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sented by respondent (R. 217) did not cover petitioner's individual properties at all. A reference to that contract on page 217 shows that the Irrigation Company and petitioner contracted to convey or caused to be conveyed "all of the pumping plants, intakes, pumps, machinery, canals, flumes, laterals, leads, ditches, rights-of-way of canals and laterals and water rights, personal property *now owned by Gulf Coast Irrigation Company*" and certain contracts held by that Company. By the final contract (R. 76) the Irrigation Company recited it owned certain properties, using the identical words above quoted to describe them, and that "prior to the conveyance hereinafter called for to be executed will be the owner of *certain other lands and irrigation properties*," all of the properties to be conveyed being described on Exhibit A. Then the contract recited (R. 77) that "Irrigation Company hereby agrees that it will convey the properties described in Exhibit A to the Water Company," but it did not provide for any conveyance by petitioner to the Water Company.

The above shows that the first contract made no reference to any properties owned by petitioner but was confined to those then owned by the Irrigation Company. Likewise, that contract called for their conveyance by the Irrigation Company to the Water Company and not, as respondent states, for the Irrigation Company to transfer them to petitioner and then for him to sell them and his own properties to the Water Company.

Yet petitioner still infers that petitioner did not

transfer his individual properties to the Irrigation Company but that his title passed directly from him to the Water Company by the deed from the Irrigation Company in which petitioner joined. The facts are just the contrary. The contract provided (R. 87) that petitioner should join in any deed for the purpose of personally warranting the titles and making the personal agreements called for, as, for example, not to engage in the irrigation business for thirty years. The deed itself (R. 110-112) recites that the Irrigation Company has granted and conveyed to the Water Company the properties involved. It then recites (R. 111) that "V. L. LeTulle joins in the execution of this deed, for the purpose of warranting title to the properties hereby conveyed to Grantee and entering into and making the covenants and agreements hereinafter contained." There is not a single word in that deed whereby petitioner purported to convey any title to the Water Company, but it was solely a conveyance by the Irrigation Company.

Petitioner did not introduce any abstract of title or other muniments to show how he conveyed his properties to the Irrigation Company. The record showed he conveyed them for stock in that company. The Water Company examined the titles and was sufficiently satisfied with the conveyance from only the Irrigation Company to pay out the \$50,000 in cash and deliver the \$750,000 of bonds. These facts refute the repeated statements of respondent on this feature.

In reference to the pleadings and authorities as discussed by respondent, there are similar attempts by respondent to justify the judgment of the Circuit Court of Appeals.

Now, at the time the properties were transferred by the Irrigation Company to the Water Company, they were wholly owned by the Irrigation Company and their transfer to the Water Company came squarely within Section 112 (i) (1) (A) of the 1928 Revenue Act defining a reorganization as "including the acquisition by one corporation of * * * substantially all the properties of another corporation." When this was shown by petitioner, respondent attacked it only on the ground that bonds are not securities. The Circuit Court of Appeals, as shown by respondent on page 11 and 12, reversed the case on the ground never raised by the government that, as to petitioner's properties, this was a mere device resorted to by petitioner. The respondent, although admitting on page 11 that the lower court "rejected the theory upon which the Government sought to meet this issue," yet contends that this issue was raised under the general proposition that petitioner must show the transaction came within the reorganization provisions. This the petitioner did, and if the government desired to avoid this on the ground of its being an alleged device, the burden was upon it, under the authorities cited in our original brief, to plead this as an affirmative defense. And we are unable to come to any other conclusion than that one of the

real purposes of respondent in dwelling at such length upon his motions for continuance and new trial was to try in this way to say that it had affirmatively pleaded that issue. It is obvious that such motions may not be used to supplement his pleadings and cure this defect therein.

We still contend that the rule announced by this Court in *General Utilities v. Helvering*, 296 U. S. 200, is applicable here and the decision of the lower court in this case is in direct conflict with it. Just as the Circuit Court of Appeals in that case, as respondent admits on page 10, on its own motion held the transaction a sham, here the lower court held petitioner's transfer was a mere device. In that case this Court squarely held that ground for reversal was not before the lower court as not raised by the Commissioner, and we cannot see how this "device" defense was available to the court below in this case.

The decisions of, neither the Circuit Court of Appeals nor of this Court in *Gregory v. Helvering*, 293 U. S. 465, 69 F. (2d) 809, are in point, either on the question of pleading or on the merits. There the taxpayer owned all the stock of United Mortgage Corporation which in turn owned stock in Monitor Securities Corporation. The taxpayer wanted to sell the Monitor stock. However, if United made the sale, it would be subject to a corporation tax, and in addition if the proceeds were distributed as a dividend, the taxpayer would be subject to the normal and surtax rate. She there-

fore had United organize the Averill Corporation, transfer the Monitor stock to Averill in payment for all of its stock which was issued to the taxpayer. She three days later dissolved Averill and received the Monitor stock on the liquidation. She then contended that she received the Averill shares in a tax free reorganization, that she received the Monitor shares under section 15(c) of the 1928 Act as an exchange for her Averill shares, and was taxable at the lower capital gain rate on the value of the Averill shares less certain applicable costs. The Commissioner disregarded the whole transaction and held it was merely a dividend of the Monitor shares and assessed a normal and surtax tax on the value of the *Monitor shares*. The taxpayer appealed to the Board of Tax Appeals and the Commissioner affirmatively raised that defense. Losing before the Board, the Commissioner appealed on the same grounds. The Circuit Court of Appeals substantially sustained the Commissioner but said that it would recognize all the steps taken but treat them as a sham and the tax should be computed on the value of the *Averill shares* received as an ordinary dividend instead of on the value of the Monitor shares. Since the value of the Averill and Monitor shares were identical, the tax was the same. Clearly there the Circuit Court of Appeals was deciding the case on exactly the grounds raised by the Commissioner, namely, that the whole transaction was a sham and had no reality. It merely held the Averill shares were the measure of the

income received and not the Monitor shares. On the other hand in the present case the lower court raised the "device" issue itself when the government never at any time before or after suit ever dreamed of it.

This Court affirmed the *Gregory* case as the transaction was a mere scheme to avoid taxes.

Helvering v. Bashford, 302 U. S. 454, and *S. A. McQueen Co. v. Commissioner*, 67 F. (2d) 857, need no comment as a mere reading of them will disclose.

In the present case there was absolutely no scheme or device or idea of evading any taxes. As we point out in our main brief, the Irrigation Company could have transferred its original properties to the Water Company for bonds and distributed them to petitioner in a tax free reorganization and he would have paid his income tax thereon as he collected the bonds. He could at the same time have sold his individual properties directly to the Water Company and paid his taxes thereon on the installment basis only as he collected them. If he had done this, as we have shown in Appendix B, he would have paid less taxes for 1931 than he actually did. As shown on pages 18 to 20 of our original brief, there were valid business reasons from petitioner's standpoint why the transaction should be carried out as it was, regardless of any incidence of taxation.

In this connection, the term "tax free reorganization" is a misnomer and often creates the er-

roneous impression that the payment of taxes are being escaped. These reorganization provisions are not loopholes or means of avoiding taxes, but merely apply the same principle available to individual sellers of property on a deferred or installment basis under Section 44 (a) and (b) of the 1928 Revenue Act and similar provisions in other Acts.

In each case the Government merely postpones collecting the tax until the taxpayer actually receives cash or its equivalent for his paper securities. In this case, petitioner recognizes that, as his bonds are paid off, he will have income taxes to pay.

We request the Court to consider the serious consequences to petitioner if the decision of the Circuit Court of Appeals stands. The Commissioner held that the Irrigation Company made an outright sale of all the properties and levied a corporation tax on that entire transaction, which taxpayer as transferee of its assets on liquidation paid. He then treated the distribution of the bonds to petitioner and his wife as a wholly taxable dividend and levied high personal taxes on them, which petitioner paid. The Government's only contention was that this was a sale because only bonds were involved and no stock. The Circuit Court of Appeals has now held that as to the original properties of the Irrigation Company it was a tax free reorganization, but petitioner's individual properties must be treated as having been sold directly by him to the Water Company, and remanded the case for further proceedings consistent with its opinion (R.

287). If petitioner is required to return to the trial court with this state of the record, it seems to us he will probably have the burden of apportioning the \$800,000 consideration between the Irrigation Company's original properties and his own individual ones. We anticipate the most strenuous objections on the part of the Government to any attempt to make such apportionment on the ground that all the properties were sold for a lump sum of \$50,000 cash and \$750,000 in bonds. If no such apportionment can be made, then petitioner will recover nothing with the result that he will have paid far more taxes than the Government was ever actually entitled to. With this the condition of the record, it is not surprising that the Government, although both lower courts overruled every ground of opposition presented by it, has been content to rest on the decision of the Circuit Court and has not applied to this Court for a writ of certiorari.

We respectfully pray that the petition for writ of certiorari be granted.

W. E. DAVANT,
HOMER L. BRUCE,
Attorneys for Petitioner.

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**WILLIAM LEMMON CROPLEY,
CLERK**

IN THE
Supreme Court of the United States

OCTOBER TERM, 1939.

No. 63.

V. L. LETULLE, *Petitioner*,

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF INTERNAL
REVENUE FOR THE FIRST DISTRICT OF TEXAS.

On Writ of Certiorari to the United States Circuit Court
of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER.

✓ W. E. DAVANT,

✓ HOMER L. BRUCE,

Attorneys for Petitioner.

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On Writ of Certiorari to the United States Circuit Court
of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER.

PRELIMINARY STATEMENT.

Petitioner has fully stated the case in his brief in support of his petition for writ of certiorari and in his reply brief to respondent's brief in opposition to his petition. This brief is in reply to the brief filed by respondent on the merits.

SUMMARY OF ARGUMENT.

I.

The Circuit Court of Appeals was not authorized to reverse the District Court on the grounds set forth in its opinion, as those were in the nature of a defense by way of confession and avoidance which respondent was required to, but did not plead. Even if they were properly raised, the lower court erred in even considering them and in reversing the case.

II.

Respondent, not having appealed from the Circuit Court of Appeals, may not raise in this court the issue as to whether the transaction between the Irrigation Company and the Water Company was a tax free reorganization or not. Even if that question were properly before this Court, it must be decided against respondent, as a transfer by one corporation of substantially all its properties to another for the latter's bonds is a tax free reorganization.

ARGUMENT.

I.

The Lower Court Erred in Its Reversal as (a) the Point Decided by It Was Not Properly Raised by Respondent and (b) the Record Did Not Justify that Court's Action.

In order that there may be no question as to the holding of the Circuit Court of Appeals we quote the following pertinent part of its opinion (R. 287):

"The evidence thus plainly shows that a large part of the property conveyed under the contract of Nov. 4, 1931, was not at that date owned by the Irrigation Company but by LeTulle, and that he conveyed it to his company by the device above stated *in order to transfer it to the purchaser along with the property of the Irrigation Company.* The statute makes no provision for the 'reorganization' of an individual. The

"plan of reorganization' which the Irrigation Company and LeTulle signed with the Water Company operated as a reorganization of the Irrigation Company, *but the property of LeTulle which was embraced in it was simply sold by him.* Using the Irrigation Company as a conduit for passing the title does not alter the substance of the matter. Only so much of the consideration as represents the price of the properties and business of the Irrigation Company is entitled to be protected from taxation as arising from a reorganization."

The Court accordingly reversed the case

"that further proceedings may be had consistent herewith."

That language of the Court is perfectly clear. It means that as to LeTulle's properties, they *were simply sold by him direct to the Water Company.* In other words the Court struck down and wholly disregarded the transfer by him to the Irrigation Company and its subsequent conveyance to the Water Company. The parallel with *General Utilities Co. v. Helvering*, 296 U. S. 200, is inescapable. There the Utilities Company distributed to its stockholders, after already negotiating a sale for them, certain stock in another company as a dividend. The stockholders then carried out the prearranged sale. The Board of Tax Appeals holding against the Commissioner, he appealed on the ground that the company by declaring the dividend thereby sold the stock and made a profit. The Circuit Court of Appeals overruled this contention, and then on its own motion disregarded the dividend and the sale by the stockholders and held the sale by the stockholders was a sale by the company. This Court held the lower court had no authority to consider the point as not properly raised. How then could the lower court here wholly disregard LeTulle's conveyance to the Irrigation Company and its transfer to the Water Company when the only contention respondent

ever made was that bonds are not securities and for that reason alone the transaction was not a tax free reorganization?

We desire a brief word in reference to the lower court's remark that "The statute makes no provision for the 'reorganization' of an individual," and respondent's argument to the same point. LeTulle transferred his properties to the Irrigation Company for stock under Section 112 (b) (5) of the Revenue Act of 1928 and not under any reorganization provision, the transfer being to a corporation of which he owned 100 per cent of the stock.

As to respondent's repeated inferences that LeTulle did not actually transfer his properties to the Irrigation Company but conveyed them directly to the Water Company, we respectfully refer to our brief in reply to respondent's brief in opposition, in which we demonstrate the fallacy of such statements.

Helvering v. Bashford, 302 U. S. 454, and *Bassick v. Commissioner*, 85 F. (2d) 8, are beside the point. In the *Bashford* case there was a complicated designed plan whereby certain stocks were passed through the Atlas Powder Company, which under the very plan itself it was required contemporaneously to pass on to another company, the whole purpose being to attempt to make Atlas a party to the re-organization and thereby allow the old stockholders of Union, Peerless and Black Diamond to get stock in Atlas free of taxes. In the *Bassick* case the whole question depended on whether Bassick and his associates owned 80 per cent of the stock of Bassick-Alemite Company. They did own 100 per cent temporarily but under the plan they were obligated immediately to convey to others enough to reduce their holdings to 41 per cent, and the court properly held they did not have the necessary "control".

Those and similar cases might be applicable in a contest on LeTulle's transfer of his properties to his Irrigation Company if he had been under contract to sell the stock he received, but that is not the case and that transaction never has been, and could not successfully be, questioned.

Here the Water Company desired to take over this whole irrigation project, whether owned by the Irrigation Company or LeTulle. Neither part was sufficient without the other. The agreement between the Irrigation Company and the Water Company made no reference as to how the Irrigation Company should acquire LeTulle's properties. He could have transferred them to his company for nothing as a capital contribution, sold them for cash or notes, or, as he did, transfer them for stock. As between the two companies and as far as the plan of reorganization was concerned, the method was immaterial.

The Irrigation Company acquired them and, when it executed the deed to the Water Company, it owned them in their entirety. Section 112(i)(1)(A) says that a reorganization includes "the acquisition by one corporation of . . . substantially all the properties of another corporation." When the conveyance was made, the Irrigation Company owned the properties. The statute does not say that it must have owned every one of them at the time the plan of reorganization was executed.

There was nothing but the utmost good faith. The whole transaction was carried out in a business way and for good business reasons. There was no scheming to get around the tax statutes as was done in the *Gregory*, *Bashford* and *Bassick* cases.

The statute was complied with, and for a court to deny its plain and unequivocal effect not only must there be found a far more fatal device than can possibly exist in this case but the government must let the taxpayer know that it intends to go outside the statute by pleading the device that it claims removes the taxpayer from the protection plainly given by the statute itself.

Such a defense is one by way of confession and avoidance—confessing that the legal requirements of the statute were complied with but its effect should be avoided because of the alleged device. Matters in confession and avoidance must always be pleaded affirmatively by the party relying

thereon. *General Utilities Co. v. Helvering*, *supra*; *Budd v. Commissioner*, 83 F. (2d) 509, 512; *Marshall v. Commissioner*, 57 F. (2d) 633, 634; *Commissioner v. Neaves*, 81 F. (2d) 947, 948-9.

In this case the Irrigation Company and LeTulle filed their income tax returns on the basis that he had conveyed these properties to the Irrigation Company for stock on a tax free basis (Section 112(b)(5)) and that the Irrigation Company had transferred them with its other properties to the Water Company for bonds in a tax free reorganization. The Commissioner accepted the returns on that basis—that is, that the Irrigation Company owned the individual properties and transferred them to the Water Company—and the only change that he made was to treat the latter transfer as taxable solely on the ground that bonds were not securities. In the District Court and in the Circuit Court of Appeals the government followed the same course, treating the properties as belonging to the Irrigation Company and seeking to sustain the tax that was levied against the Irrigation Company on the theory that it had made a taxable profit when it sold these same properties. The government collected the tax from LeTulle as transferee that it levied on the Irrigation Company on the profit it claimed that company made out of these very properties. In view of this record we submit that it is entirely too late for the government now to swap horses, at the instance and suggestion of the Circuit Court of Appeals, and now claim the right to break the transaction down into two parts, one a tax free reorganization and the other a sale by LeTulle to the Water Company.

Incidentally if such a position were tenable—and we submit it is not—then there would still be no tax on the Irrigation Company as its transfer was held by the Circuit Court of Appeals to be tax free and petitioner would still be entitled to recover the corporation tax that he paid as transferee.

II.

Respondent, Not Having Appealed to this Court, May Not Raise the Issue as to Whether the Reorganization Was Tax Free. Even if Properly Before this Court, it is Well Settled that it was a Non-Taxable Reorganization.

• In spite of the fact that respondent has not appealed, he in part II of his brief seeks to relitigate in this Court the issue decided against him by both courts below that the transfer by the Irrigation Company to the Water Company was not a tax free reorganization because only bonds were involved and no stock. The Circuit Court of Appeals directly held that it was a tax free reorganization, and in the absence of an appeal by respondent, he is in no position to raise this issue in this court. *Helvering v. Pfeiffer*, 302 U. S. 247; *Federal Trade Commission v. Pacific States Paper Trade Association*, 273 U. S. 52; *Bothwell v. United States*, 254 U. S. 231; *Peoria & Pekin Union Ry. Co. v. U. S.*, 263 U. S. 528; *Bolles v. Outing Company*, 175 U. S. 262; *Alexander v. Cosden Pipe Line Company*, 290 U. S. 484; *Morley Construction Co. v. Maryland Casualty Co.*, 300 U. S. 185; *U. S. v. American Railway Express Co.*, 265 U. S. 425; *Landram v. Jordan*, 203 U. S. 56.

However, this question has long been definitely settled. The Irrigation Company transferred substantially all of its properties to the Water Company for \$50,000 cash and \$750,000 of long term bonds. This came within Section 112(i)(1)(A) defining a reorganization as including "the acquisition by one corporation of . . . substantially all the properties of another corporation." Section 112(b)(4) provides that no gain or loss shall be recognized if a corporation a party to a reorganization exchanges property for "stock or securities" of another corporation. The statute uses the word "or" and not "and", and clearly means that the Irrigation Company could receive either stock or securities or both, and no gain would be recognized.

Such was the Treasury Department's construction of prior similar statutes. Regulations 62, Art. 1556, under 1921 Revenue Act, and similar regulations under all subsequent acts; Cumulative Bulletin III-2 p. 26 (1924); Cumulative Bulletin III-2 p. 34; Cumulative Bulletin V-1 p. 10 (1926); Cumulative Bulletin V-2 p. 11; *Williams v. Commissioner*, 15 B. T. A. 227 (1929); *First National Bank v. Commissioner*, 21 B. T. A. 415 (1930).

In its decisions in December, 1935; this Court affirmatively settled the question. *Helvering v. Minnesota Tea Co.*, 296 U. S. 378; *Nelson Co. v. Helvering*, 296 U. S. 374; and *Helvering v. Watts*, 296 U. S. 387, in which last case this Court held that bonds were securities within the meaning of the act.

Since those decisions the Board of Tax Appeals and the Circuit Courts of Appeal have all held that an exchange of properties for bonds is a tax free reorganization even though no stock is involved. *Carl B. Segall v. Commissioner*, 38 B. T. A. 43; *Kaspere Cohn Co. v. Commissioner*, 35 B. T. A. 646; *Frederick L. Leckie v. Commissioner*, 37 B. T. A. 252; *Lilienthal v. Commissioner*, 80 F. (2d) 411; *Burnham v. Commissioner*, 86 F. (2d) 776; *Commissioner v. Kitselman*, 89 F. (2d) 458; *Commissioner v. Newberry Lumber and Chemical Co.*, 94 F. (2d) 447; *Commissioner v. Freund*, 98 F. (2d) 201; *Commissioner v. Tyng*, 106 F. (2d) 55. The law is well summarized by Justice Hand in the *Tyng* case as follows:

"Five different Circuit Courts of Appeal, besides our own, and the Court of Claims as well, have decided that the receipt of 'securities' results in the retention of a continuity of interest necessary for a reorganization. We reached this conclusion in *Watts v. Commissioner*, 2 Cir., 75 F. (2d) 981, afterwards affirmed by the Supreme Court sub nomine *Helvering v. Watts*, supra. The following decisions are to the same effect: *Scofield v. LeTulle*, 5 Cir., 103 F. 2d. 20, 22; *Commissioner v. Freund*, 3 Cir., 98 F. 2d. 201, 205; *Commissioner v. Newberry L. and C. Co.*, 6 Cir., 94

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 81 L. Ed. 886; *Lilienthal v. Commissioner*, 9 Cir., 80
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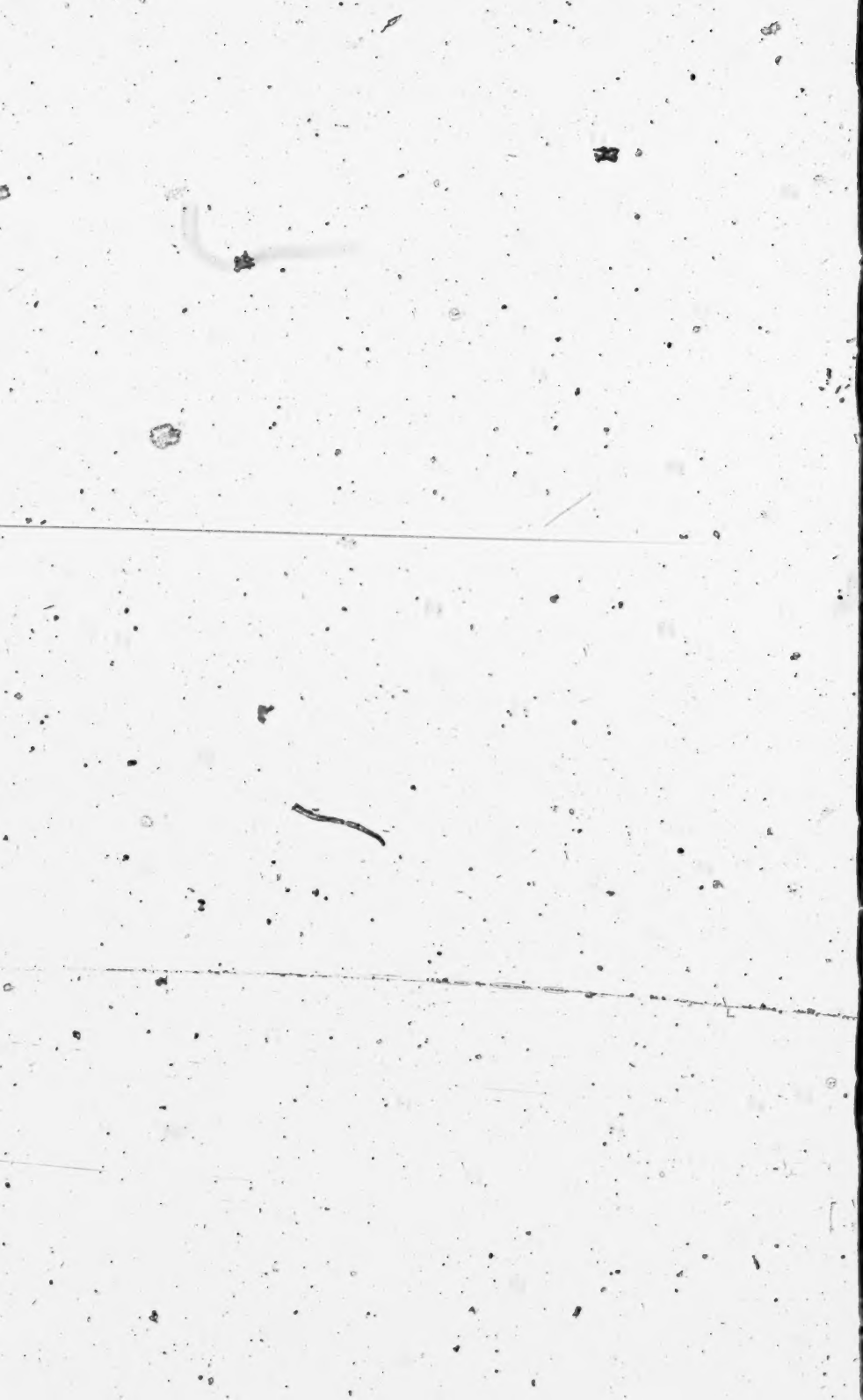
Worcester Salt Co. v. Commissioner, 75 F. 2d 251, was decided prior to *Helvering v. Watts*, *supra*, and is not the law. *Pinellas Ice Co. v. Commissioner*, 287 U. S. 462 and *Cortland Specialty Co. v. Commissioner*, 60 F. 2d 937, involved short term notes which were held not to be securities.

CONCLUSION.

Petitioner respectfully prays that the judgment of the Circuit Court of Appeals be reversed and that of the District Court be affirmed and for such other relief as he may be entitled to.

Respectfully submitted,

W. E. DAVANT,
 HOMER L. BRUCE,
Attorneys for Petitioners



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No. 68

In the Supreme Court of the United States

OCTOBER TERM, 1939

V. L. LETULLE, PETITIONER

v.

**FRANK SCOFIELD, UNITED STATES COLLECTOR OF IN-
TERNAL REVENUE FOR THE FIRST DISTRICT OF
TEXAS**

**ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH
CIRCUIT**

BRIEF FOR THE RESPONDENT IN OPPOSITION



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(1)

In the Supreme Court of the United States

OCTOBER TERM, 1939

No. 63

V. L. LeTULLE, PETITIONER.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF TEXAS

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

No written opinion was filed by the trial court. The opinion of the Circuit Court of Appeals (R. 283-287) is reported in 103 F. (2d) 20.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 3, 1939 (R. 288). A petition for rehearing was filed April 21, 1939 (R. 289), and was denied April 27, 1939 (R. 293). Petition for a writ of certiorari was filed May 22, 1939. The

jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in the circumstances of this case, the exemption from taxation applicable to corporate reorganizations applies to a transfer of property which was owned, at the time of the agreement upon which the claimed reorganization was based, not by the transferor corporation, but by the taxpayer, its sole stockholder, and which was conveyed to the transferor corporation, if at all, only in order to be included in the properties conveyed to the transferee.

STATUTES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(b) Exchanges solely in kind.—

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(d) *Same—Gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, * * *

(g) *Distribution of stock on reorganization.*—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the dis-

tributee from the receipt of such stock or securities shall be recognized * * *

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term “reorganization” means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (E) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

STATEMENT

In 1931 the taxpayer was the sole stockholder of the Gulf Coast Irrigation Company (R. 65), which owned certain pumping plants, machinery, canals and other irrigation property (R. 76). The taxpayer individually owned certain other lands and irrigation properties (R. 287).

Pursuant to a contract dated November 4, 1931 (R. 75-90), the Gulf Coast Irrigation Company agreed to convey to the Gulf Coast Water Company all of the irrigation properties it then owned,

as well as "certain other lands and irrigation properties" which it "will be the owner of" prior to the time of conveyance (R. 76). The other lands and irrigation properties referred to in the contract were those then owned by the taxpayer individually. The transfer was to be made for a consideration of \$50,000 in cash and \$750,000 in secured bonds of the Water Company (R. 77).

The record discloses the method by which the taxpayer endeavored to include his individual property in the reorganization scheme.

On November 7, 1931, after the agreement with the Water Company had been executed, a special meeting of the stockholders of the Irrigation Company approved the proposed reorganization (R. 96). The minutes of this meeting state (R. 95) that the taxpayer, "desiring also to reorganize his interest in the properties", had consented to be a party to the reorganization. To this end, an increase of the capital stock of the Irrigation Company from 1,000 shares to 2,660 shares was authorized (R. 94).

The minutes of a special meeting of the board of directors of the Irrigation Company, held on the same day, indicate that the taxpayer had subscribed for the new stock and had agreed to pay the sum of \$166,000 "in property to be conveyed" to the company (R. 101). Thereafter, on November 18, 1931, the Irrigation Company (through the taxpayer as its president) and the taxpayer individually, joined

in a deed transferring the properties to the Water Company (R. 110-112). The record fails to disclose the transfer of the taxpayer's individual property to the Irrigation Company before the latter purported to transfer it to the Water Company.

Additional taxes for the fiscal period during which the transaction occurred were assessed against the petitioner as transferee and against the petitioner and his wife individually, on the ground that taxable gains resulted from the disposition of the property. The tax was paid and in due time suits were commenced to recover the amounts so paid, asserting that the transaction was a non-taxable corporate reorganization. The Government denied generally the allegations of the petitions. The cases were consolidated.

At the trial the taxpayer testified that he had made a prior contract for the sale of these irrigation properties to the Continental Service Company (R. 178). Thereafter, during the trial, the Government filed a motion for continuance (R. 41-57) for the purpose of developing the true situation. The motion alleged that the Government would be able to show that the taxpayer individually had already sold his properties before he agreed to transfer them to the Gulf Coast Irrigation Company for 1,660 shares of its stock, and that he should have accounted for the profit on the sale in his individual income tax return. The Government's motion further asserted that the contract of November 4, 1931, upon which the taxpayer was

relying to show a reorganization, was "a sham and a subterfuge to put into another form a completed transaction in order to avoid the tax that was due on such completed transaction" (R. 52).

The trial judge overruled the Government's motion for continuance (R. 58) and ordered judgment in favor of the taxpayer for the full amount (R. 59-61).

The Government again asserted that the property had been disposed of by the taxpayer before the purported reorganization, in its motion for a new trial (R. 205-213), which was denied by the trial judge (R. 266). At that time the Government had been able to get a copy of the original contract for the sale of the properties dated November 5, 1930, and executed by the taxpayer individually and as president of the Gulf Coast Irrigation Company (R. 217-224). Extracts of corporate minutes had also been obtained (R. 208-209) showing that the contract had been kept alive, that down payments had been made thereon and that the transferee of the rights thereunder was proceeding to close the deal. It was further asserted in the motion for new trial (R. 212) that evidence then available would show that there had been an outright sale of the assets in question before November 4, 1931, and that the contract dated November 4, 1931, "was entered into between the parties merely for the purpose of calling the transaction a reorganization for the sole and exclusive purpose of attempting to evade taxes."

In the assignment of errors (R. 270-276) exceptions were specifically taken to the refusal of the trial court to grant the Government's motion for continuance (R. 274) and its motion for a new trial (R. 275), and it was asserted that had an opportunity been given to prove the averments made in the motions it would have been demonstrated that the taxpayer had disposed of the property individually owned by him by an outright sale under the prior contract instead of through the purported reorganization.

The Circuit Court of Appeals did not regard the denial of the Government's motions as error but instead, on the basis of the facts established by the evidence in the record, reversed the judgment of the trial court insofar as it had applied the reorganization provisions to the properties individually owned by the taxpayer at the time the contract was entered into (R. 287).

ARGUMENT

1. We submit that the provisions of the statute precluding recognition of gain in corporate reorganizations do not apply to such transfers of the taxpayer's individual property as that shown by the evidence admitted in the record in this case, and that on that record the decision of the court below, reversing the judgment in part, is correct.

While the Government's primary defense had been that the bonds received from the acquiring corporation did not constitute a sufficient continu-

ing interest to sustain the application of the reorganization provisions to any part of the transaction, the fundamental issue before the court was whether the transaction was a reorganization within the meaning of the statute. The court below correctly held that the transfer of the taxpayer's individual property which was shown by the plaintiff's evidence was not a reorganization.

The petitioner, apparently seeking to overthrow the decision below on the ground that the Circuit Court of Appeals had no authority to apply to the facts any legal reasoning not urged upon the Court by the parties, relies primarily upon *General Utilities Co. v. Helvering*, 296 U. S. 200, as presenting a basis for certiorari. The cases are clearly different. In that case, the petitioner, a corporation, owned stock of another corporation which had enhanced in value. The petitioner declared a dividend which it paid in the stock of the other corporation at an agreed value per share, greater than the cost of the stock. The Government sought to tax the petitioner to the extent of such excess on the ground that it had declared a cash dividend and had disposed of the stock in liquidating the indebtedness thereby created. In asking the Circuit Court of Appeals to reverse, the Government's petition stated (p. 204):

The only question to be decided is whether the petitioner [taxpayer] realized taxable income in declaring a dividend and paying it in stock of another company at an agreed

value per share, which value was in excess of the cost of the stock.

The Court of Appeals answered that question in the negative but reversed upon the ground that the record as a whole disclosed a scheme on the part of the taxpayer to sell the stock and at the same time avoid the tax by going through the formality of declaring a dividend, distributing the stock in payment thereof and having the stockholders then deliver the stock to the purchaser. The Court of Appeals concluded that the stockholders were mere agents or conduits through whom the transfer of the stock was accomplished and that such a transaction should be disregarded as a sham. This ground was entirely new in the case and, as this Court pointed out (pp. 206-207) in reversing the Circuit Court of Appeals, involved an inference of fact directly in conflict with the stipulation of the parties and the findings.

Here, on the other hand, the record clearly shows that the property transferred included assets which at the time of the contract of sale were not the property of the corporation, which, as far as this record discloses, never were transferred to it, and which, if they ever became property of the Irrigation Company, did so for purposes wholly unrelated to that company's business.

The Government's defense in this case was based upon the general ground that the transactions in question involved a sale rather than a reorganization, and, although it was especially urged that the

bonds received from the Water Company did not constitute a sufficient continuing interest to establish a reorganization, the fundamental issue was whether the transaction brought the taxpayer within the exemption of the reorganization provisions. Although it rejected the theory upon which the Government sought to meet this issue, the Circuit Court of Appeals did not depart from the issue in deciding that as to the part of the assets which admittedly belonged to the taxpayer individually the transaction was a sale rather than a reorganization. The taxpayer had assumed the burden of showing that a reorganization occurred within the meaning of the statute. Under prior decisions of this Court, this required a showing of a genuine transfer of the old company's assets acquired and disposed of in the pursuit of its corporate purposes, as well as a continuing interest in the new company; the tracing of one company's genuine business assets into the other company in exchange for a substantial interest in the new company. Even though it be conceded that the taxpayer showed a sufficient continuity of interest through the acquisition of the secured bonds, nevertheless, as the Circuit Court of Appeals pointed out (R. 287):

The evidence [thus] plainly shows that a large part of the property conveyed under the contract of Nov. 4, 1931, was not at that date owned by the Irrigation Company but by LeTulle, and that he conveyed it to his

company by the device above stated in order to transfer it to the purchaser along with the property of the Irrigation Company.

In *Helvering v. Gregory*, 69 F. (2d) 809 (C. C. A. 2d), affirmed, 293 U. S. 465, a similar situation was presented. There, the sole stockholder of an existing corporation desired to become owner of certain of the corporate assets. The assets were transferred to a new corporation, wholly owned by the taxpayer and created for the purpose of reducing taxes by receiving the assets and immediately issuing them to the taxpayer as a liquidating dividend. There, even more carefully than in this case, the forms of a reorganization were observed. There, too, the fundamental question was whether the transaction, formally correct, amounted to a reorganization within the meaning of the statute, and the Circuit Court of Appeals reversed upon a theory different from any advanced by the parties. The Government had contended that the new corporation should be disregarded and the transfers to and through it treated as inoperative. The Court of Appeals reversed on the ground that there was no reorganization, but upon a different theory, saying (p. 811):

We do not indeed agree fully with the way in which the Commissioner treated the transaction; we cannot treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by the Averill Corporation of its own shares to

the taxpayer, and her acquisition of the Monitor shares by winding up that company. The Averill Corporation had a juristic personality, whatever the purpose of its organization; the transfer passed title to the Monitor shares and the taxpayer became a shareholder in the transferee. All these steps were real, and their only defect was that they were not what the statute means by a "reorganization," because the transactions were no part of the conduct of the business of either or both companies; so viewed they were a sham, though all the proceedings had their usual effect.

This Court found no objection to the Circuit Court of Appeals exercising its judicial function by deciding the case on grounds different from those advanced by the parties, and affirmed the decision in an opinion which we believe is conclusive on the point involved here. *Gregory v. Helvering*, 293 U. S. 465. The concluding paragraph of that opinion is precisely applicable to the facts shown by the record in this case, if we disregard the lack of evidence here that title to the plaintiff's property was ever formally transferred to the Irrigation Company preparatory to the execution of that company's deed to the Water Company. The Court said (293 U. S. 470):

In these circumstances, the facts speak for themselves, and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of

subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.

Although in the present case the trial court rejected the Government's offer to show that the original contract was with the taxpayer individually, that he was to acquire the property owned by the old corporation and to transfer it along with his own property in an outright sale, and that the later scheme was entered into solely to avoid taxes and bring the taxpayer's individual property within the scope of the reorganization statute, it is clear from the evidence introduced by the plaintiff himself that his own property was brought into the transaction as purported corporate property only for the purposes of this transaction, after the agreement was entered into, and not as a part of the Irrigation Company's business.¹

¹ Excluding from consideration the irrelevant controversy as to whether the motive for including the taxpayer's property in the transaction was tax avoidance or convenience in foreclosing on the bonds taken in exchange for the property, it is evident from the argument in the taxpayer's brief in support of the petition here that his property was not in-

The conclusion that only those portions of the assets which were corporate assets when the agreement was entered into were within the scope of the reorganization exemption was, we submit, clearly within the province of the court below, in determining the legal effect of the facts proved by the taxpayer; and the conclusion reached was clearly correct.

The Irrigation Company owned only a part of the property to be transferred. It agreed to acquire and transfer, in addition to its properties, certain other property then owned by the taxpayer (R. 76). After the agreement was completed the taxpayer, the sole stockholder of the Irrigation Company (Pet. p. 2), went through the formality of calling a special stockholders' meeting at which an increase in the capital stock of the corporation was authorized (R. 92-105). A few days later, a deed was executed by the corporation and by the taxpayer individually, transferring the properties so combined to the new corporation (R. 110-112). The record fails to show any transfer of the property from the taxpayer to the Irrigation Company. Here, as in *Helvering v. Bashford*, 302 U. S. 454, 458, even if a transfer of the taxpayer's property to the selling corporation were to be found in the record, any direct ownership by the selling corpora-

cluded in the transaction in furtherance of any corporate purpose of the Irrigation Company but merely to accomplish one or another of several possible personal advantages to the taxpayer as distributee of the proceeds of the transaction (Pet. pp. 17-22).

tion would be "transitory and without real substance," and part of a plan which contemplated the immediate transfer of the assets to the new company.

On the basis of such facts the court below was correct in excluding the taxpayer's property from the benefits of the reorganization exemption, *Gregory v. Helvering*, 293 U. S. 465; *S. A. MacQueen Co. v. Commissioner*, 67 F. (2d) 857 (C. C. A. 3d), and in remanding the case for the purpose of ascertaining the proper apportionment between the corporate and individual properties thus transferred.

The decision turns upon the peculiar facts of this case. The facts involved in the cases relied upon by the petitioner (Pet. 9-10) are so different that the decisions present no conflict and furnish no ground for the issuance of a writ of certiorari.

CONCLUSION

The case depends largely upon its own facts and was correctly decided below. There is no conflict. The petition should be denied.

Respectfully submitted.

GOLDEN W. BELL,

Acting Solicitor General.

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SEWALL KEY,

JOSEPH M. JONES,

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Special Assistants to the Attorney General.

JULY 1939.

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No. 63

In the Supreme Court of the United States

OCTOBER TERM, 1939

V. L. LETULLE, PETITIONER

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF
INTERNAL REVENUE FOR THE FIRST DISTRICT OF
TEXAS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

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In the Supreme Court of the United States

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No. 63

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**FRANK SCOFIELD, UNITED STATES COLLECTOR OF
INTERNAL REVENUE FOR THE FIRST DISTRICT OF
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**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE FIFTH CIRCUIT**

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

No written opinion was filed by the trial court. The opinion of the Circuit Court of Appeals (R. 211-215) is reported at 103 F. (2d) 20.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 3, 1939 (R. 216). A petition for rehearing was filed, and was denied April 27, 1939 (R. 217). Petition for a writ of certiorari was

filed May 22, 1939, and was granted October 9, 1939 (R. 220). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether, in the circumstances of this case, the exemption from taxation applicable to corporate reorganizations applies to a transfer of property which was owned, at the time of the agreement upon which the claimed reorganization was based, not by the transferor corporation, but by the taxpayer, its sole stockholder, and which was conveyed to the transferor corporation, if at all, only in order to be included in the properties conveyed to the transferee.

2. Whether the acquisition by one corporation of all the properties of another is a reorganization when the consideration consists entirely of cash and bonds, with the result that the transferor has only the interest of a creditor.

STATUTE INVOLVED

The pertinent provisions of the statute involved are printed in the Appendix, *infra*, pp. 26-28.

STATEMENT

In 1931 the taxpayer was the sole stockholder of the Gulf Coast Irrigation Company (R. 47-48), which owned certain pumping plants, machinery, canals and other irrigation property (R. 55). The

taxpayer individually owned certain other lands and irrigation properties (R. 61, 215):

Pursuant to a contract dated November 4, 1931 (R. 55-64), the Gulf Coast Irrigation Company agreed to convey to the Gulf Coast Water Company all of the irrigation properties it then owned, as well as "certain other lands and irrigation properties" which it "will be the owner of" prior to the time of conveyance (R. 55). The other lands and irrigation properties referred to in the contract were those then owned by the taxpayer individually. The transfer was to be made for a consideration of \$50,000 in cash and \$750,000 in secured bonds of the Water Company (R. 56-57).

The record discloses the method by which the taxpayer endeavored to include his individual property in the so-called reorganization scheme.

On November 7, 1931, after the agreement with the Water Company had been executed, a special meeting of the stockholders of the Irrigation Company approved the proposed reorganization (R. 69-70). The minutes of this meeting state (R. 70) that the taxpayer, "desiring also to reorganize his interest in the properties", had consented to be a party to the reorganization. To this end, an increase of the capital stock of the Irrigation Company from 1,000 shares to 2,660 shares was authorized (R. 69-70).

The minutes of a special meeting of the board of directors of the Irrigation Company, held on the

same day, indicate that the taxpayer had subscribed for the new stock and had agreed to pay the sum of \$166,000 "in property to be conveyed" to the company (R. 74-75). Thereafter, on November 18, 1931, the Irrigation Company (through the taxpayer as its president) and the taxpayer individually, joined in a deed transferring the properties to the Water Company (R. 81-83). The record fails to disclose the transfer of the taxpayer's individual property to the Irrigation Company before the latter purported to transfer it to the Water Company.

Additional taxes for the fiscal period during which the transaction occurred were assessed against the petitioner as transferee and against the petitioner and his wife individually, on the ground that taxable gains resulted from the disposition of the property (R. 47-49, 51-53). The tax was paid and in due time suits were commenced to recover the amounts so paid, asserting that the transaction was a nontaxable corporate reorganization (R. 1-13, 14-30). The Government denied generally the allegations of the petitions (R. 13-14, 30). The cases were consolidated (R. 31):

At the trial the taxpayer testified that he had made a prior contract for the sale of these irrigation properties to the Continental Service Company (R. 134). Thereafter, during the trial, the Government filed a motion for continuance (R. 31-44) for the purpose of developing the true situa-

tion. The motion alleged that the Government would be able to show that the taxpayer individually had already sold his properties before he agreed to transfer them to the Gulf Coast Irrigation Company for 1,660 shares of its stock, and that he should have accounted for the profit on the sale in his individual income-tax return. The Government's motion further asserted that the contract of November 4, 1931, upon which the taxpayer was relying to show a reorganization, was "a sham and a subterfuge to put into another form a completed transaction in order to avoid the tax that was due on such completed transaction" (R. 40).

The trial judge overruled the Government's motion for continuance (R. 44) and ordered judgment in favor of the taxpayer for the full amount (R. 45-46).

The Government again asserted that the property had been disposed of by the taxpayer before the purported reorganization, in its motion for a new trial (R. 153-159). This motion was denied by the trial judge (R. 200). At that time the Government had been able to obtain a copy of the original contract for the sale of the properties dated November 5, 1930, and executed by the taxpayer individually and as president of the Gulf Coast Irrigation Company (R. 162-168). Extracts of corporate minutes had also been obtained (R. 155-158) showing that the contract had been kept alive, that down payments had been made thereon and that

the transferee of the rights thereunder was proceeding to close the deal. It was further asserted in the motion for a new trial (R. 159) that evidence then available would show that there had been an outright sale of the assets in question before November 4, 1931, and that the contract dated November 4, 1931, "was entered into between the parties merely for the purpose of calling the transaction a reorganization for the sole and exclusive purpose of attempting to evade taxes."

In the assignment of errors (R. 202-206) exceptions were specifically taken to the refusal of the trial court to grant the Government's motion for continuance (R. 205) and its motion for a new trial (R. 206), and it was asserted that had an opportunity been given to prove the averments made in the motions it would have been demonstrated that the taxpayer had disposed of the property individually owned by him by an outright sale under the prior contract instead of through the purported reorganization.

The Circuit Court of Appeals did not regard the denial of the Government's motions as error but instead, on the basis of the facts established by the evidence in the record, reversed the judgment of the trial court in so far as it had applied the reorganization provisions to the properties individually owned by the taxpayer at the time the contract was entered into (R. 215).

SUMMARY OF ARGUMENT

I

The court below did not depart from the issue presented by the record. It merely held that the *reason* advanced by the Collector for holding the transaction outside the reorganization provision of the statute was without merit, but held that, for a different reason, that part of the property previously belonging to the taxpayer was not property of the corporation which could be transferred without the recognition of gain.

The Circuit Courts of Appeals are not limited to a consideration of the *reasons* advanced in support of a contention. The authorities do not support the taxpayer's argument that the court below had no authority to apply to the facts any legal reasoning not urged by the parties.

The court below correctly held that the properties of a corporation which may be transferred in a tax-free reorganization cannot include properties transferred to the corporation merely for the purpose of re-transfer to the purchasing corporation. Any temporary holding of the taxpayer's property by the Irrigation Company under the facts of this case was transitory and without real substance.

The decision below rests on the conclusion that the reorganization provisions of the statute were intended to cover transfers of only such assets as could be deemed corporate properties in a sub-

stantial sense, and the court did not err in its remand by failing to allow the introduction of additional evidence.

II

The decision below also should be affirmed on the further ground that the transfer of properties to the Water Company did not in fact and in law constitute a reorganization within the meaning of the statute. As interpreted by the decisions of this Court, the acquisition by one corporation of all of the property of another corporation is not alone sufficient to constitute a reorganization. In addition, the transferring corporation, or its stockholders, must acquire a direct, definite, and material interest of a proprietary nature in the affairs of the purchasing corporation. The interest represented by the bonds of the purchasing corporation is not such an interest in the affairs of that corporation as is contemplated by the statute.

ARGUMENT

I

THE CIRCUIT COURT OF APPEALS CORRECTLY HELD THAT INsofar AS PETITIONER'S PERSONALLY OWNED PROPERTIES WERE INCLUDED IN THE TRANSACTION, IT WAS NOT A REORGANIZATION WITHIN THE MEANING OF THE STATUTE

(A) THE CIRCUIT COURT OF APPEALS DID NOT DEPART FROM THE ISSUE

The issue presented to the Circuit Court of Appeals was whether or not a tax-free reorganization

occurred when the Irrigation Company transferred certain properties to the Water Company in consideration of cash and bonds of the Water Company. The Circuit Court of Appeals held that the transaction was a reorganization insofar as it affected the property of the Irrigation Company, but that it was not a reorganization insofar as it affected the taxpayer's individual property which was sought to be included in the corporate transaction.

We submit that this decision was within the issue presented. Confining itself to the question of reorganization, the Circuit Court of Appeals merely held that the *reason* asserted by the Government in support of the contention that the transaction was wholly outside of the reorganization provision was without merit, but that for another reason the transaction was partly outside of such provision.

It has never been the law that the Circuit Courts of Appeals are limited to a consideration of the *reasons* advanced in support of a contention. So long as they keep within the issue, parties are entitled to support their contentions in the Circuit Courts of Appeals with new arguments, new authorities, and new reasoning not presented in the trial court. Similarly, the court of its own *motion* is authorized to apply v authorities and new reasoning and decide the question as justice may require.

In this litigation the Government originally contended that this transaction was not a reorganiza-

tion; petitioner, on the other hand, contended that the transaction was a reorganization. The Circuit Court of Appeals was not required to agree entirely with either contention. It was free to hold that the transaction was partly a reorganization and partly a sale, and that is precisely the effect of its decision. Because the Government did not suggest the possibility that the transaction might be so regarded is no reason for denying it the benefit of the judgment of the Circuit Court of Appeals.

Petitioner's contention that the Circuit Court of Appeals had no authority to apply to the facts any legal reasoning not urged upon the court by the parties is clearly not supported by the authorities. In *General Utilities Co. v. Helvering*, 296 U. S. 200, the question presented to the Circuit Court of Appeals was whether a corporation realized taxable income by satisfying a dividend liability in stock which cost it a lesser amount. However, the court undertook to decide that the corporation realized taxable income upon the sale of the dividend stock by the stockholders. Not only was this a new and different issue, but in deciding it the Circuit Court of Appeals drew an inference of fact directly in conflict with the stipulation of the parties and the findings, to wit, that the stockholders in making the sale acted as agents of the corporation.

Unlike that case, the Circuit Court of Appeals here has confined itself to the issue presented and made no inconsistent inferences of fact. The rec-

ord clearly shows that the property transferred in the purported reorganization included assets which at the time of the contract of sale were not the property of the corporation; that the price was agreed upon by the vendee on the basis of the property then owned by the corporation and "certain other lands and irrigation properties" of which it would become owner¹; and that petitioner's individual property was sought to be included in the corporate reorganization. As a matter of law, the reorganization provisions of the statute do not extend to transfers of property by an individual to a corporation except where the individual is in control of the corporation immediately after the transfer. Section 112 (b) (5). We submit that the Circuit Court of Appeals was clearly authorized to decide that the transaction was a reorganization only insofar as it affected the transfer of the corporate property.

In a similar situation dealing with a reorganization question, the Circuit Court of Appeals for the Second Circuit in *Helvering v. Gregory*, 69 F. (2d) 809, disagreed with the reasoning of the Commissioner, but nevertheless sustained his position upon a theory developed by the court. In that case the Government had contended that the new corporation should be disregarded and the transfer to and through it treated as inoperative. The Circuit

¹ The record does not show of what those other properties consisted. (Pet. 5.)

Court of Appeals held that the corporation should not be disregarded but nevertheless held that the transaction was not a reorganization. The court said (p. 811):

We do not indeed agree fully with the way in which the Commissioner treated the transaction; we cannot treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by the Averill Corporation of its own shares to the taxpayer, and her acquisition of the Monitor shares by winding up that company. The Averill Corporation had a juristic personality, whatever the purpose of its organization; the transfer passed title to the Monitor shares and the taxpayer became a shareholder in the transferee. All these steps were real, and their only defect was that they were not what the statute means by a "reorganization," because the transactions were no part of the conduct of the business of either or both companies; so viewed they were a sham, though all the proceedings had their usual effect.

This Court affirmed the decision (293 U. S. 465), and evidently regarded the action of the Circuit Court of Appeals as a proper exercise of its judicial function.

Petitioner's contention that the burden was upon the Government to plead and prove as an affirmative defense that petitioner had resorted to a scheme or device to avoid taxes is apparently

grounded upon a misconception of the decision of the Circuit Court of Appeals. That court did not decide that petitioner must forfeit the benefit of the reorganization provisions because of fraud. The device to which the court referred was the device of including individual property in a corporate reorganization. That does not involve any element of fraud and petitioner's contention that the Circuit Court of Appeals has decided a question which should have been pleaded and proved is wholly lacking in force.

(B) THE TERM "PROPERTIES" OF A CORPORATION WITHIN THE MEANING OF THE REORGANIZATION PROVISIONS DOES NOT INCLUDE ASSETS TRANSFERRED TO THE CORPORATION MERELY FOR THE PURPOSE OF RE-TRANSFER.

Pursuant to a contract dated November 4, 1931, the Irrigation Company agreed to convey all of the irrigation properties it then owned as well as "certain other lands and irrigation properties" which it "will be the owner of" prior to the actual transfer (R. 55). The "other lands and irrigation properties" thus referred to were then owned by the petitioner individually. The record fails to disclose the transfer of petitioner's individual property to the Irrigation Company before the transfer to the purchaser. It does show that on November 18, 1931, the Irrigation Company (through the petitioner as president) and the petitioner individually joined in a deed transferring the properties to the purchaser (R. 81-83). Since petitioner was the

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plaintiff and had the burden of proof, he is not entitled to any assumptions in his favor. Nevertheless, the Circuit Court of Appeals did assume that petitioner conveyed his individual property to the Irrigation Company. The court said (R. 215):

On Nov. 7, 1931, a meeting of the stockholders of the Irrigation Company was held at which the capital stock of the Company was increased from \$100,000 to \$266,000. The entire increase was thereupon subscribed for by LeTulle, and paid for in property conveyed to the Company at a price of \$166,000. The stockholders' meeting then ratified the contract of Nov. 4, 1931, and authorized the conveyance of all its properties and business accordingly. The evidence thus plainly shows that a large part of the property conveyed under the contract of Nov. 4, 1931, was not at that date owned by the Irrigation Company but by LeTulle, and that he conveyed it to his company by the device above stated in order to transfer it to the purchaser along with the property of the Irrigation Company. The statute makes no provision for the "reorganization" of an individual. The "plan of reorganization" which the Irrigation Company and LeTulle signed with the Water Company operated as a reorganization of the Irrigation Company, but the property of LeTulle which was embraced in it was simply sold by him. Using the Irrigation Company as a conduit for passing the title does

not alter the substance of the matter. Only so much of the consideration as represents the price of the properties and business of the Irrigation Company is entitled to be protected from taxation as arising from a reorganization.

Thus the decision of the court below rests upon an interpretation of the applicable reorganization provision of the statute as dealing exclusively with corporate "properties" in a substantial sense. The reorganization provisions deal with transfers of property by an individual to a corporation, but such a transaction is not within the statute unless the individual owns at least 80 per centum of the stock of the transferee immediately after the transfer. Section 112 (b) (5) and 112 (j). However, under another provision of the statute a reorganization occurs upon "the acquisition by one corporation of * * * substantially all the properties of another corporation." (Section 112 (i) (1) (A).) Accordingly the question is whether petitioner's individually owned properties are "properties" of a corporation within the meaning of Section 112 (i) (1) (A). Assuming that they were actually conveyed to the Irrigation Company, that company was committed to reconvey them to the Water Company, and we think they were not properties of the Irrigation Company in the substantial sense contemplated by the statute. Accordingly we submit that the court below correctly

decided that the reorganization provisions of the statute are not applicable to such assets.

This Court has interpreted the reorganization provisions as disregarding a temporary holding of stock on the ground that it "was transitory and without real substance; it was part of a plan which contemplated the immediate transfer of the stock."

Helvering v. Bashford, 302 U. S. 454, 458. See also *Bassick v. Commissioner*, 85 F. (2d) 8, 10 (C. C. A. 2d), certiorari denied, 299 U. S. 592; rehearing denied, 299 U. S. 623. We submit that the same principle is applicable here and that petitioner's individually owned assets had no relation to any business conducted by the corporation. Cf. *Western Industries Co. v. Helvering*, 82 F. (2d) 461, 464 (App. D. C.). Therefore, they could not properly be treated as its "properties" for the purpose of applying the reorganization provisions.

(C) THERE IS NO OCCASION TO REMAND FOR THE INTRODUCTION
OF ADDITIONAL EVIDENCE

Petitioner's contention that the Circuit Court of Appeals should in any event have authorized the introduction of additional evidence upon the remand is based upon a misconception. He assumes (Br. 23) that the Circuit Court of Appeals attempted to bring this case within the decision of this Court in *Gregory v. Helvering*, 293 U. S. 465, and he contends (Br. 18-22) that if given an opportunity he could establish that the transfer of his individually owned property to the Irrigation

Company and the retransfer by the Irrigation Company to the purchaser served a business purpose which would take the case out of the principle of the *Gregory* decision.

However, the Circuit Court of Appeals did not cite the *Gregory* case and, as heretofore stated, we submit that the decision below rests upon the conviction that the reorganization statute was intended to cover a transfer of only such assets as could be deemed corporate properties in a substantial sense. If this is a true construction of the reorganization statute, it is obvious that it would be futile to remand the case for further findings. Cf. *General Utilities Co. v. Helvering*, 296 U. S. 200, 207. Moreover, petitioner's argument does not indicate that he would be able to prove that the transaction was in furtherance of any corporate purpose of the Irrigation Company. His argument merely tends to show that the purpose was to accomplish one or another of several possible personal advantages to petitioner himself as a distributee of the proceeds of the transaction.

If we are mistaken in our understanding of the opinion of the Circuit Court of Appeals, and if, properly construed, it holds that as a matter of law the sale of the LeTulle properties must be regarded as a direct sale by LeTulle to the Water Company, then the case apparently rests upon the principle that the Revenue Acts implicitly require that a business purpose be served by the transac-

tion. *Helvering v. Gregory, supra.* If the opinion of the Circuit Court of Appeals be so construed, we concede that the petitioner should have the opportunity to present additional evidence upon that point if he can, although nothing yet suggested indicates that any business purpose was served by the form which the transaction took. Since petitioner does not suggest that the *Gregory* decision is otherwise inapplicable, he is not entitled to any further relief.

II

THE DECISION BELOW SHOULD BE AFFIRMED ON THE GROUND THAT THE TRANSACTION INVOLVED DID NOT CONSTITUTE A REORGANIZATION.

In any event, we urge that the decision of the Circuit Court of Appeals, reversing in part the judgment of the District Court, be affirmed on the ground that the property transferred to the Gulf Coast Water Company was not disposed of in a reorganization as defined by Section 112 (i) of the Revenue Act of 1928, c. 852, 45 Stat. 791, and that the bonds of the Water Company received by the taxpayer in liquidation of the Gulf Coast Irrigation Company did not constitute securities of a corporation a party to a reorganization within the meaning of Section 112 (b) (3) of that Act.

Section 112 (i) of the 1928 Act, *supra*, provides:

- (1) The term "reorganization" means
- (A) a merger or consolidation (including

the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization; or (D) a mere change in identity, form, or place of organization, however effected.

In this case the Gulf Coast Water Company acquired substantially all of the property of the Gulf Coast Irrigation Company for \$50,000 cash and \$750,000 face value of its own bonds, payable serially over a period of twelve years, and secured by a mortgage on the properties so transferred.

The language of the above definition does not in terms exclude the sale of stock or assets of a corporation for cash, or for cash and bonds or short-term notes, but it is now established by the decisions of this Court that the definition contained in the statute is a restricted one (*Groman v. Commissioner*, 302 U. S. 82, 86), and that the selling corporation or its stockholders must acquire a direct, definite, and material interest in the affairs of the purchasing corporation in order to comply with the exempting provisions of the statute. *Pinellas Ice Co. v. Commissioner*, 287 U. S. 462; *Nelson Co. v.*

Helvering, 296 U. S. 374, 377; *Helvering v. Minnesota Tea Co.*, 296 U. S. 378, 385; *Groman v. Commissioner*, 302 U. S. 82, 89; *Helvering v. Bashford*, 302 U. S. 454.

Accordingly, the fact that the acquisition of the assets falls within the literal terms of the section does not mean that such transaction is a statutory reorganization. See particularly *Worcester Salt Co. v. Commissioner*, 75 F. (2d) 251, 252 (C. C. A. 2d), and cases there cited. There must be "some assured participation in the properties of the transferee." *Cortland Specialty Co. v. Commissioner*, 60 F. (2d) 937, 940 (C. C. A. 2d), certiorari denied, 288 U. S. 599. In that case, approved by this Court in *Pinellas Ice Co. v. Commissioner*, 287 U. S. 462, 470, the court said (p. 940):

Each transaction presupposed a continuance of interest on the part of the transferor in the properties transferred. * * * Judge Groner's opinion in *Corbett v. Burnett*, 60 App. D. C. 202, 50 F. (2d) 492, is in accord. In defining "reorganization," section 203 of the Revenue Act gives the widest room for all kinds of changes in corporate structure, but does not abandon the primary requisite that there must be some continuity of interest on the part of the transferor corporation or its stockholders in order to secure exemption.

And in *Helvering v. Minnesota Tea Co.*, *supra*, the Court, after explaining this principle as laid

down in the *Pinellas Ice Co.* case, *supra*, and after quoting therefrom at length, said (p. 385):

And we now add that this interest must be definite and material; it must represent a substantial part of the value of the thing transferred. This much is necessary in order that the result accomplished may genuinely partake of the nature of merger or consolidation. [Italics supplied.]

In *Pinellas Ice Co. v. Commissioner*, *supra*, and in *Cortland Specialty Co. v. Commissioner*, *supra*, it clearly was indicated that in order to meet the requirements of the statute there must be some "real semblance to a merger or consolidation" and "some assured participation in the properties of the transferee."

Worcester Salt Co. v. Commissioner, *supra*, involved facts substantially similar to the facts in the instant case. There the taxpayer purchased all of the stock of the Kerr-Remington Salt Company on June 1, 1928. Thereafter, the latter transferred to the taxpayer all of its assets, subject to its liabilities, in exchange for \$680,000 bonds of the taxpayer. The Circuit Court of Appeals for the Second Circuit pointed out (*id.*, p. 252) that by this transfer the taxpayer acquired the properties of the Kerr-Remington Salt Company and the transaction fell within the definition of "reorganization" contained in Section 112 (i) (1) (A) of the 1928 Act, *supra*. It added, however (P. 252):

But the fact that the transaction is included within the literal terms of this section does

not mean that such a transaction is a statutory reorganization. * * * This transaction was a purchase of assets, not a reorganization. * * * The transaction in the instant case in no sense can be deemed to "partake of the nature of a merger or consolidation." The Kerr-Remington Salt Company had no interest in the petitioner because, like the notes in the *Pinellas Case*, bonds are merely an evidence of indebtedness and gave the Kerr-Remington Salt Company no interest in the petitioner itself. Continuity of interest is a requisite.

But compare *Lilienthal v. Commissioner*, 80 F. (2d) 411 (C. C. A. 9th), and *Commissioner v. Freund*, 98 F. (2d) 201 (C. C. A. 3d).

The court below recognized that the decision of this Court in *Helvering v. Watts*, 296 U. S. 387, is not controlling here because that case arose under a different clause of the statute, and the question concerning the bonds was merely whether they were "securities." In the *Watts* case all of the stock of one corporation was transferred to another in exchange for stock of the latter, and, in addition, for mortgage bonds guaranteed by the latter. The transaction was held to be a reorganization because a part of the consideration was stock, and therefore the decision merely announced that the presence of the bonds would not defeat the reorganization. The question here is whether a transfer for a large amount of cash becomes a reorganization merely by substituting bonds for approximately 90 per

ntum of the purchase price, and the *Watts* case does not answer that question.

The question whether a reorganization occurred under Section 112 (i) (1) is a different question from whether bonds are securities under Section 112 (b) (3). In every reorganization case it is first necessary to determine whether there has been a reorganization within the meaning of the definition of Section 112 (i) (1). A determination that this definition is satisfied leads to the second question, whether the operative provisions which grant the exemption, e. g., Section 112 (b) (3), are applicable. In the *Watts* case it was only necessary to consider the stock in answering the first question, while here the answer to that question turns upon whether the bonds represent a sufficient continuity of interest to satisfy the accepted test. We submit that bonds alone do not satisfy that requirement because they are merely evidences of indebtedness. This contention is squarely supported by the decision in *Averill v. Commissioner*, 101 F. (2d) 44 (C. C. A. 1st), where the court said (p. 647) that the *Watts* case does not decide that the ownership of bonds without stock constitutes such a continuing interest as is essential to a statutory reorganization.

In rejecting the collector's contention the court now appears to rest its decision (R. 213-214) upon the decision of this Court in *Nelson Co. v. Belvering*, *supra*, where the selling corporation re-

ceived preferred stock in the buying corporation for its assets. That case is not controlling, however, because preferred stock clearly represents an entirely different interest in the assets of the issuing corporation from that represented by bonds, whether secured or unsecured. The latter merely evidences an indebtedness of the issuing corporation. Bonds confer no greater proprietary interest in the property of the issuing corporation than the short-term notes involved in *Pinellas Ice Co. v. Commissioner, supra*.

This Court has never passed upon the precise question involved in this case. We submit, however, that upon authority of the decisions discussed above, it is evident that bonds, secured or unsecured, do not represent such an interest in the property transferred therefor as to constitute a reorganization within the meaning of the statute.

A somewhat similar question was before the Circuit Court of Appeals for the Second Circuit in *Commissioner v. Tyng*, 106 F. (2d) 55, in which a different conclusion was reached. A petition for a writ of certiorari is being prepared in that case and will be filed shortly.

CONCLUSION

The decision of the court below is correct. It is supported by the facts and the law and should be affirmed. In any event, the decision should be affirmed for the reason that the taxpayer is liable for

the tax upon the full amount of gain realized during the taxable year.

Respectfully submitted.

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F. E. YOUNGMAN,

Special Assistants to the Attorney General.

NOVEMBER 1939.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat: 791:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

* * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it

in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, * * *

(g) *Distribution of stock on reorganization.*—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term “reorganization” means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

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CHARLES ELMORE CROPLEY
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IN THE
Supreme Court of the United States

OCTOBER TERM, 1939

V. L. LETULLE, *Petitioner,*

v.

**FRANK SCOFIELD, UNITED STATES COLLECTOR OF
INTERNAL REVENUE FOR THE FIRST DISTRICT
OF TEXAS, *Respondent.***

**On Writ of Certiorari to the United States Circuit Court
of Appeals for the Fifth Circuit.**

PETITION FOR REHEARING

**W. E. DAVANT,
HOMER L. BRUCE,
*Attorneys for Petitioner.***

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No. 63

IN THE
Supreme Court of the United States

OCTOBER TERM, 1939

V. L. LETULLE, *Petitioner*,

v.

FRANK SCOFIELD, UNITED STATES COLLECTOR OF
INTERNAL REVENUE FOR THE FIRST DISTRICT
OF TEXAS, *Respondent*.

On Writ of Certiorari to the United States Circuit Court
of Appeals for the Fifth Circuit.

PETITION FOR REHEARING

Comes now the above named petitioner, V. L. LeTulle, and presents this his petition for rehearing in the above entitled cause, and in support thereof respectfully shows:

Preliminary Statement.

This case arose under the 1928 Revenue Act. The irreconcilable conflict between Regulations 74 of the Treasury Department under that act and the holding of this Honorable Court in this case can best be illustrated by a comparison of the applica-

ble provisions of the regulations with the pertinent language of this Court's opinion, as follows:

REGULATIONS 74

ART. 574. Exchanges in connection with corporate reorganizations.—

* * If two or more corporations reorganize, for example, by—* *

(3) The acquisition by the Y Corporation * * of substantially all of the properties of the X Corporation, * *

then no taxable income is received from the transaction by the X Corporation * * if the sole consideration received by the corporation is stock or securities of the Y Corporation * *

ART. 577. Definitions.—

* * *

As used in section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 574 are complied with if "stock and securities".

OPINION

Where the consideration is wholly in the transferee's bonds, or part cash and part such bonds, we think it cannot be said that the transferor retains any proprietary interest in the enterprise. * *

We conclude that the Circuit Court of Appeals was in error in holding that, as respects any of the property transferred to the Water Company, the transaction was other than a sale or exchange upon which gain or loss must be reckoned in accordance with the provisions of the revenue act dealing with the recognition of gain or loss upon a sale or exchange.

are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

The wording of each revenue act and the treasury regulations promulgated thereunder from the 1921 Act to and including the 1932 Act were substantially identical. In view of these facts and of the last two paragraphs of Mr. Justice Roberts' dissenting opinion in *Higgins v. Smith* decided by this Court on January 8, 1940, it is impossible for us to believe that Mr. Justice Roberts in writing the opinion in this case, and this Court in making its decision, had in mind these regulations and the legislative history of these acts.

I.

The uniform interpretation of the 1928 Revenue Act and prior revenue acts by the Treasury Department and by the courts and the repeated re-enactment by Congress of identical provisions after such interpretation, demonstrate that the transfer of the properties by the Irrigation Company to the Water Company for bonds was a tax free reorganization.

The majority of this Court in *Higgins v. Smith*,

decided on January 8, 1940, recognized the force of long continued administrative constructions of a taxing statute, but decided that case on the ground that the government had changed its construction prior to the transaction there involved and held that the change operated validly after that date. Mr. Justice Roberts in his opinion in that case states:

"I am of opinion that where taxpayers have relied upon a long unvarying series of decisions construing and applying a statute, the only appropriate method to change the rights of the taxpayers is to go to Congress for legislation. In my view, the resort to Congress on the one hand for amendment, and the appeal to the courts on the other, for a reversal of construction, which, if successful, will operate unjustly and retroactively upon those who have acted in reliance upon oft-reiterated judicial decisions, are wholly inconsistent.

"I am of opinion that the courts should not disappoint the well founded expectation of citizens that, until Congress speaks to the contrary, they may, with confidence rely upon the uniform judicial interpretation of a statute. The action taken in this case seems to me to make it impossible for a citizen safely to conduct his affairs in reliance upon any settled body of court decisions."

The transaction here involved occurred on November 4, 1931, and up to and considerably past that time the uniform construction of the applicable revenue acts by the Treasury Department was that, where a corporation acquired all of the stock of another corporation or substantially all of its properties in exchange for bonds, the transaction was a

reorganization. There is nothing in any of the revenue acts prior to that of 1934 requiring the selling corporation to retain a "proprietary" interest through stock ownership in the purchasing corporation, and it was only in the 1934 Act that any such stock ownership provision was inserted.

The legislative history and the regulations and rulings of the Treasury Department beginning with the Revenue Act of 1921 down through and including that of 1932 were consistent that this transaction was a reorganization.

For the ready reference of the Court, we include in the appendices to this petition copies of the applicable Revenue Acts of 1921, 1924, 1926, 1928, 1932 and 1934¹ and the corresponding Regulations 62, 65, 69, 74 and 77, the regulations under the 1934 Act being omitted as that statute introduced a material change from the prior acts.

The Revenue Act of 1918², had very loose provisions concerning reorganizations. That section read as follows:

"Section 202 (b). When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; but when in connection with the reorganization, merger, or consolidation of a corporation a person receives in place of stock or securities owned by him new stock or secur-

¹42 Stat. c. 136, p. 227, 229, 230; 43 Stat. c. 234, p. 253, 256-258; 44 Stat. c. 27, p. 9, 12-14; 45 Stat. c. 852, p. 791, 816-818; 47 Stat., c. 209, p. 169, 196-198; 48 Stat. c. 277, p. 704, 705.

²Section 202 (b), 40 Stat. c. 18, p. 1057, 1060.

ities of no greater aggregate par or face value, no gain or loss shall be deemed to occur from the exchange, and the new stock or securities received shall be treated as taking the place of the stock, securities, or property exchanged.

"When in the case of any such reorganization, merger or consolidation the aggregate par or face value of the new stock or securities received is in excess of the aggregate par or face value of the stock or securities exchanged, a like amount in par or face value of the new stock or securities received shall be treated as taking the place of the stock or securities exchanged, and the amount of the excess in par or face value shall be treated as a gain to the extent that the fair market value of the new stock or securities is greater than the cost (or if acquired prior to March 1, 1913, the fair market value as of that date) of the stock or securities exchanged."

These loose provisions proved unsatisfactory and substantial changes were made when the 1921 Act was passed. That act in Section 202 (c)² provided in part:

"but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—

"(2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word 'reorganization', as used in this paragraph, includes a merger or consolidation (including the

²42 Stat. c. 136, p. 230.

acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected)."

Here was the first attempt to state what the word "reorganization" should include, and the words used in parenthesis"

"(including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation)"

were there introduced for the first time, and were re-enacted in the Revenue Acts of 1924, 1926, 1928 and 1932⁴ without change. Regulations 62 under the Revenue Act of 1921 provided in part as follows:

"ART. 1566. Exchange of property which results in no gain or loss.— * * *

"(b) * * Under this paragraph it makes no difference whether the stock or securities received are or are not of a like kind or class.

* * * Where two or more corporations unite their properties, by * * (2) the sale of its property by B to A, * * or (6) the ac-

⁴Sec. 203 (h), 1924 Act, 43 Stat., c. 234, p. 257; Sec. 203 (h), 1926 Act, 44 Stat. c. 27, p. 14; Sec. 112 (i), 1928 Act, 45 Stat. c. 852, p. 818; Sec. 112 (i), 1932 Act, 47 Stat. c. 209, p. 198.

quisition by A * * of substantially all of the properties of B, no taxable income is received from the transaction by A or B or by the stockholders of either corporation A or corporation B, provided the sole consideration received by the stockholders is stock or securities of corporations A or B or any corporation a party to or resulting from the reorganization."

Under the foregoing plain and unequivocal provisions, if Corporation B sold substantially all of its properties to Corporation A for stock or bonds of Corporation A, the Treasury Department stated that no taxable income would be received by Corporation A.

The Revenue Act of 1924⁵, in so far as the provisions involved in this case are concerned, was substantially the same as that of 1921 except in one respect. The Act of 1921 expressly provided that a person receiving stock or securities in a reorganization would have neither taxable gain nor loss but did not expressly make the same provision in reference to a corporation, although in Regulations 62 the Treasury Department ruled that a corporation transferring its properties for stock or securities would receive no taxable income. In the report of the Committee on Ways and Means to the House of Representatives⁶, on the revenue bill of 1924, this omission in the law was pointed out. That report stated in part as follows (p. 13):

⁵Secs. 203 (b) (3) and 203 (h), 43 Stat. p. 256, 257.

⁶Ways and Means Committee Report No. 179, 68th Congress, 1st Sess., p. 13.

"(2) Paragraph (3) provides that no gain or loss is recognized if a corporation, a party to a reorganization exchanges property for stock or securities in another corporation, a party to the reorganization. There is no corresponding provision of the existing law, although this paragraph embodies the construction placed by the Treasury Department upon the existing law. The statute should contain a definite rule on this question."

There was inserted in the 1924 Act as Section 203 (b) (3) the following provision:

"No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization."

That is the same identical language as is found in Section 203 (b) (3) of the Revenue Act of 1926⁷ and Section 112 (b) (4) of the 1928 and 1932 Acts⁸.

In the same report of the House Committee on Ways and Means on the 1924 Act, the Committee stated (p. 14):

"It should be noted that in paragraphs (b) and (c) of this section, as well as in other provisions of the proposed bill, the conjunction 'or' is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of paragraph (2) are complied with if 'stock and securities' are received in exchange as well

⁷44 Stat. p. 12.

⁸45 Stat. p. 816; 47 Stat. p. 196.

as if 'stock or securities' are received, and if securities in the same corporation together with securities in another corporation a party to the reorganization, or in other corporations parties to the reorganization, are received in the exchange."

As will be seen, the Treasury^o Department immediately in its regulations under the 1924 Act incorporated exactly the same wording as that last above quoted from the report of the Committee on Ways and Means, and carried the same forward into the regulations under the subsequent acts.

Regulations 65 under the Revenue Act of 1924 provided in part:

"ART. 1574. Exchanges in connection with corporate reorganizations.—* * If two or more corporations reorganize, for example, by either * * (2) the sale of its property by B to A, * * or (6) the acquisition by A * * of substantially all of the properties of B, * * then no taxable income is received from the transaction by corporation A or B if the sole consideration for the transfer of the assets is stock or securities of corporation A or B; * * ."

"ART. 1577. Definitions. * *

"As used in this section, as well as in other provisions of the statute, the conjunction 'or' is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 1572 are complied with if 'stock and securities' are received in exchange as well as if 'stock or securities' are received, and if securities in the same corporation, together with securities in another corporation a party

to the reorganization, or in other corporations parties to the reorganization, are received in exchange."

There is only one explanation for these words found in the report of the committee and in the last above quoted paragraph of the regulations. Both Congress and the Treasury Department realized that the word "or" meant "or" and that either stock *or* securities might be received in a reorganization, but they wanted it to be definitely understood that, if Corporation A in a reorganization received stock and would receive no taxable gain and if Corporation B received bonds and would receive no taxable gain, then, if Corporation C received both stock *and* bonds, Corporation C would *like*-wise receive no taxable income. In other words, realizing that the word "or" meant "or", they wanted it clearly understood that it also meant "and".

The Revenue Act of 1926* was identical with that of 1924, in so far as here applicable.

Again in Regulations 69 under the 1926 act the Treasury Department provided:

"ART. 1574. Exchanges in connection with corporate reorganizations.— * * * If two or more corporations reorganize, for example by

"(2) The sale of its property by B to A,

"(6) The acquisition by A * * of substantially all of the properties of B, * *

*Secs. 203 (b) (3) and 203 (h), 44 Stat. p. 12, 14.

then no taxable income is received from the transaction by corporation A or B if the sole consideration for the transfer of the assets is stock or securities of corporation A or B;

"ART. 1577. Definitions.—* *

"As used in Section 203, as well as in other provisions of the statute, the conjunction 'or' is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of Article 1574 are complied with if 'stock and securities' are received in exchange as well as if 'stock or securities' are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange."

In addition to these interpretations in the regulations, the Treasury Department published in 1926, Income Tax Unit Ruling 2306¹⁰ under the 1926 Revenue Act. There the M Corporation transferred the stock of the O Company to the P Company solely for bonds of P Company. The Department held that the transaction

"was a reorganization transaction whereby stock in a corporation a party to such reorganization (O Company) was exchanged *solely* for bonds of another corporation a party to the reorganization (P Company). On such a transaction no gain or loss is recognized, the basis of the bonds to the M Corporation being the cost or other basis of the O Company stock to the M Corporation."

¹⁰C. B. V-2, p. 11.

The 1926 Act provided that a reorganization included the acquisition by one corporation of all the stock of another corporation or of substantially all of its properties, and the above illustration, although involving stock, applies equally to one involving properties. In the above illustration the selling company (M) exchanged the stock of O Company *solely* for bonds of the P Company and the Treasury Department held that this was a tax free reorganization.

The Revenue Act of 1928¹¹, which is the act under which this case arises, was the same as that of 1926. Again, Regulations 74 under that act provided in part:

"ART. 574. Exchanges in connection with corporate reorganizations.— * * If two or more corporations reorganize, for example, by—
* * *

"(3) The acquisition by the Y Corporation * * of substantially all of the properties of the X Corporation, * *

then no taxable income is received from the transaction by the X Corporation * * if the sole consideration received by the corporation is stock or securities of the Y Corporation;
* *

"ART. 577. * *

"As used in Section 112, as well as in other provisions of the Act, the conjunction 'or' is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of Article 574 are complied with if 'stock and securities'

¹¹Secs. 112 (b) (4) and 112 (i), 45 Stat. p. 816, 818.

are received in exchange as well as if 'stock or securities' are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange."

Those regulations, which were the ones under which this transaction in November, 1931, was made, when applied to this case, read:

"If two or more corporations reorganize, for example, by—

"(3) The acquisition by the Y Corporation (Gulf Coast Water Company) * * of substantially all of the properties of the X Corporation (Gulf Coast Irrigation Company) * *

then no taxable income is received from the transaction by the X Corporation (Gulf Coast Irrigation Company) * * if the sole consideration received by the corporation (Gulf Coast Irrigation Company) is stock or securities (bonds) of the Y Corporation (Gulf Coast Water Company)."

It will be noted that this occurs in Article 574 of these regulations. In Article 577, it was provided:

"For example, the provisions of Article 574 are complied with if 'stock and securities' are received in exchange as well as if 'stock or securities' are received."

Under the express wording of those regulations the transfer by the Irrigation Company of its prop-

erties to the Water Company for bonds of the Water Company gave rise to no taxable income on the part of the Irrigation Company.

In 1931, the year in which the reorganization in this case took effect, it was universally considered that an exchange of properties for bonds was a tax free reorganization. One of the most widely distributed tax services is the Federal Tax Service of Commerce Clearing House, Inc. That service on July 22, 1931¹², gave the following illustration and discussion:

"Problem: A owned 51 per cent or more of the issued voting and nonvoting, if any, stock of X Co. In 1927, he transferred all his said stock in X Co. to corporation, Y Co., receiving therefor 24 per cent of the agreed sale price in cash, and balance in bonds issued by Y Co., maturing serially over a period of 8 years. Let us assume, for illustration purposes, that these shares in X Co. cost A \$100,000, were sold for \$200,000 to Y Co., represented by \$48,000 cash, and \$152,000 in bonds, issued by Y Co., worth their par value of \$152,000. What is A's income tax liability?

"Answer: This transaction classifies as a 'reorganization' under Section 112 (i)(1)(A), 1928 Act, and corresponding Section 203 (h)(1)(A) of the 1926 Act (311 CCH par. 715). See also par. 718,13. It is the acquisition by one corporation (by Y Co.) of at least a majority (51 per cent) of the voting stock, and at least a majority (51 per cent) of the total number of shares of all other issued classes of stock in another corporation (in X Co.). X Co. and Y Co. are each 'a party to the re-

¹²C. C. H. Vol: 312, par. 4034, Illustrative Cases—Bulletin F.

organization', as that term is defined in Section 112 (i) (2), 1928 Act, and 203 (h) (2) of 1926 Act (311 CCH par. 717 and 718.14).

"Consequently, the amount of the 'recognized' gain of 'A' from said 1927 reorganization transaction is to be determined under applicable Sections 203 (b) (2), 1926 Act (same as in 112 (b) (3), 1928 Act) for which see 311 CCH par. 702 and 702.03; and under the further applicable Section 203 (d) (1), 1926 Act, same as in 112 (c) (1), 1928 Act (311 CCH par. 706, and 718.06).

"Under those sections the \$100,000 gain of A is then 'recognized', as taxable gain, but in a sum not in excess of the \$48,000 cash item received by him.

"The bonds in Y Co. classify as 'securities', as that word is used in Section 203, 1926 Act, and 112 of 1928 Act, so as in 203 (b) (2), 1926 Act, and 112 (b) (3) of 1928 Act. See I. T. 2301; G. C. M. 3291; S. M. 2723; and I. T. 2258; reported at 311 CCH par. 743.13, 743.216, 784.05, and 730.04; also court decision in Williams v. Com., 44 Fed. (2d) 467, at par. 697.222; and First National Bank of Champlain v. Com., 21 BTA 415, reported at 1930 CCH par. 7902."

The 1932 Act¹³ and Regulations 77 thereunder were substantially identical with those under the 1928 Act and will not be repeated.

The 1934 Revenue Act, however, changed the definition of reorganization so as to require stock to be obtained by the selling company. If this Court were construing in this case the 1934 Revenue

¹³Secs. 112 (b) (4) and 112 (i), 47 Stat. p. 196, 198.

Act¹⁴, its holding might be correct. We illustrate the change that was made in the 1934 Act by comparing it with the 1928 Act:

1928 ACT

1934 ACT

Section 112 (i) (1).
The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation).

Section 112 (g) (1).
The term "reorganization" means (A) a *statutory* merger or consolidation, or (B) the acquisition by one corporation *in exchange solely for all or a part of its voting stock*: of at least *80 per centum* of the voting stock and at least *80 per centum* of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation.

As shown by the reports of the Senate Committee on Finance¹⁵ and of the House Committee on Ways and Means¹⁶, the House proposed to eliminate the part in parenthesis in Section 112 (i) defining a reorganization, which part included the acquisition of a majority of the stock or substantially all the properties of another corporation, and thus limit

¹⁴Sec. 112 (g), 48 Stat. c. 277, p. 705.

¹⁵Senate Finance Committee Report No. 558, 73rd Congress, 2nd Sess. p. 16.

¹⁶Ways and Means Committee Report No. 704, 73rd Congress, 2nd Sess.

reorganizations to (1) statutory mergers and consolidations; (2) transfers to a controlled corporation, "control" being defined as 80 per cent ownership; and (3) changes in the capital structure or form of organization. The Senate did not concur in such a limitation because many states had no laws dealing with mergers or consolidations, and therefore inserted clause (B) in Section 112 (g) (1) of the 1934 Act, above quoted. There is the first time that the Revenue Acts require stock to be received, and Congress thereby, particularly in view of the legislative history of the prior acts, clearly shows that under the prior acts it did not intend to require any "proprietary" interest to be essential through stock ownership in the acquiring corporation.

The regulations and rulings by the Treasury Department under the prior acts were directly in accord with the policy of Congress. If the regulations were clearly wrong and in conflict with the congressional policy, then this Honorable Court might be justified in ignoring them and interpreting the statute to carry out the policy of Congress. On the other hand, the regulations were justified under the statute and were in accord with congressional policy. That policy has been, in a case like this where the gain is represented only by paper profits evidenced by bonds that may or may not be paid in whole or in part, to postpone the levy of an income tax on the gain until the taxpayer actually receives cash for the bonds or securities.

In the report of the Committee on Ways and

Means to the House under the 1924 Act, *supra*, the committee stated (p. 13):

"Congress has heretofore adopted the policy of exempting from tax the gain from exchanges made in connection with a reorganization in order that ordinary business transactions will not be prevented on account of the provisions of the tax law. If it is necessary for this reason to exempt from tax the gain realized by the stockholders, it is even more necessary to exempt from tax the gain realized by the corporation."

The same statement in identical words was made to the Senate by the Committee on Finance.

Treasury Regulations 65 under the 1924 Act, Article 1574, set out this policy:

"Since corporate reorganizations which result only in a change in form and which do not substantially affect the property interests either of the shareholders or of the corporations may be required or may be made desirable by business conditions, State laws, or other causes, the statute provides that no gain or loss shall be recognized to the shareholders from the exchange of stock made in connection with the reorganization nor to the corporations from the exchange of property made in connection with the reorganization. * * *

"In conformity with the principle of ignoring for tax purposes those reorganizations which result merely in a change in form, the statute provides further that the stock received by the shareholders in connection with the reorganization shall have the same basis for the purpose of determining gain or loss from its subsequent sale as the stock surrendered by them

and that the assets acquired by a corporation a party to the reorganization shall have the same basis for the purposes of depreciation, depletion, and the determination of gain or loss from subsequent sale as they had in the hands of the corporation from which they were acquired. (See Arts. 1596-1598.) The exchanges made by both the shareholders and the corporations in connection with a reorganization are ignored and both are treated thereafter as if the reorganization had not occurred."

In conformity with this policy, there is as much reason for exempting from immediate taxation a gain represented by bonds as a gain represented by stock. In each case no cash is received, and the reorganization statute was written in order that trades similar to the one here under consideration might be made. Ultimately the Government will receive income taxes on account of this trade, for, as the bonds are paid off, the petitioner will pay taxes on the gain actually realized, this gain being the difference between the amount paid on the bonds and the cost of his stock in the Irrigation Company, which became his basis for these bonds.

This congressional policy of not taxing paper gains on reorganizations until the paper gains have been converted into cash was in direct accord with congressional policy in allowing other parties, making sales of property for a small amount of cash and deferred notes, to report their profit on an installment basis and to pay an income tax on the profit realized only as and when the installment

notes or obligations were actually paid and the seller received cash¹⁷.

We will discuss the attitude of the Government in connection with this question. As heretofore pointed out, the 1932 Act (which was passed after the transaction in this case had been closed) reenacted provisions of the 1928 Act and the Treasury Department's regulations under that act repeated the regulations under the 1928 Act, reaffirming that this transaction was tax free. It was generally accepted by the courts that this question was finally settled by this Court in *Helvering v. Watts*¹⁸, decided December 16, 1935, and the other tax cases decided on that day¹⁹. In the *Watts* case there was an exchange of stock in Corporation A for stock in Corporation B and bonds in another corporation a party to the reorganization. The Government contended that the bonds were other property and were not securities within the meaning of the act. The Circuit Court of Appeals²⁰, in holding against the Government, went into a detailed history of these acts and concluded that, under the continued construction of the act and the regulations of the Treasury Department, the bonds were securities and the transaction was a tax free reorganization. All of

¹⁷See Sec. 44 (b) Revenue Act of 1928, 45 Stat. p. 805, and corresponding sections of other revenue acts.

¹⁸296 U. S. 387.

¹⁹*John A. Nelson & Co. v. Helvering*, 296 U. S. 374; *Helvering v. Minnesota Tea Co.*, 296 U. S. 378.

²⁰*Watts v. Com.*, 75 F. 2d 981.

the courts and the Board of Tax Appeals since that time have assumed (and we submit correctly) that those decisions foreclosed this question.

It is highly significant that the *Watts case* was decided by this Court on December 16, 1935, and just prior thereto on December 5, 1935, the Ninth Circuit Court of Appeals decided the *Lilienthal case*²¹. In that case a corporation acquired a majority of the stock of another corporation in exchange for cash and its ten-year bonds. The Government in that case for the first time raised the point that these bonds were not securities. The Circuit Court of Appeals held against the Government but the Government did not apply to this Honorable Court for writ of certiorari. If it were convinced of the soundness of its position, it could have had this Court immediately settle this whole question right there in the *Lilienthal case*. It is also highly significant that in the present case, where the Circuit Court of Appeals held that this was a tax free reorganization, the Government did not seek a review of that question by this Honorable Court but in fact opposed the application of petitioner for a writ.

It is interesting to note the attitude of the Government in the converse situation of where bonds are exchanged for stock.

In Solicitor's Memorandum 2723²², an exchange of bonds for stock and bonds was held a reorgani-

²¹*Lilienthal v. Commissioner*, 80 F. 2d 411.

²²C. B. III-2, p. 26.

zation. In I. T. 2071²³, a transfer of bonds for stock was held to result in no recognizable loss. In I. T. 2238²⁴, an exchange of bonds for preferred stock was a reorganization. In *First National Bank v. Commissioner*²⁵, holders of bonds in one corporation exchanged them for preferred stock in another corporation, and the Government's contention that no loss should be recognized, as this was a reorganization, was sustained.

The *Pinellas and Cortland Specialty Company cases*²⁶ did not involve the point, as the notes in those cases were of such short term that they were held to be the equivalent of cash and were not securities.

In *Worcester Salt Company v. Commissioner*²⁷, there was a sale of assets by a subsidiary to its parent corporation for bonds. The point decided by the Board was that this was not governed by the reorganization provisions because it was a transaction occurring between affiliated companies during the period of affiliation and was controlled by the parts of the act dealing with affiliated companies. The decision was affirmed by the Circuit Court of Appeals which court explained in *L. &*

²³C. B. III-2, p. 34.

²⁴C. B. V-1, p. 10.

²⁵21 B. T. A. 415.

²⁶*Pinellas Ice & Cold Storage Co. v. Com.*, 287 U. S. 462; *Cortland Specialty Co. v. Com.*, 60 F. 2d 937.

²⁷29 B. T. A. 526, 75 F. 2d 251.

*E. Stirn, Inc. v. Commissioner*²⁸, that it had placed its decision in that case on the ground that it construed the bonds involved in that case not to be "securities".

In 1935, long after petitioner's transaction had been closed and after the Revenue Act of 1934 had introduced the new provisions concerning transfer of assets solely for stock, but prior to the decisions of this Court in December, 1935, the Board in *McNab v. Commissioner*²⁹, held with the Government that, where there was an exchange of stock in one corporation for cash and bonds, there was no reorganization, but that contention was made by the Government long after 1931. The taxpayer did not appeal.

In *Newberry Lumber & Chemical Company v. Commissioner*³⁰, the Board held that where bondholders of a defunct corporation through a foreclosure sale had the properties transferred to a corporation for stock, this was not a reorganization, but the Circuit Court of Appeals reverse¹ the Board and held that it was a reorganization, and the Commissioner did not appeal to this Court.

In *Küselman v. Commissioner*³¹, a similar bond foreclosure case under which the bondholders got stock in the new corporation was involved, and the

²⁸107 F. 2d 390.

²⁹33 B. T. A. 192.

³⁰33 B. T. A. 150 (Oct. 3, 1935), 94 F. 2d 447, (Feb. 11, 1938).

³¹33 B. T. A. 494 (Nov. 19, 1935).

Board held with the Government that there was no reorganization. This was reversed by the Circuit Court of Appeals³², and the Government did not appeal (the denial of *certiorari* being on the petition of the taxpayer who appealed in connection with another issue).

In *Burnham v. Commissioner*³³, a taxpayer exchanged unsecured notes for stock and sought to deduct a loss. The government in that case contended that it was a reorganization and the Board and Circuit Court of Appeals sustained the Government's contention. There the Government did not want the taxpayer to get the advantage of a loss deduction.

In *Kaspars Cohn Company, Ltd. v. Commissioner*³⁴, the Board held against the Government that a transfer of stocks by Corporation A in exchange for cash and bonds of the purchasing corporation was a tax free reorganization. In that case the Government was seeking to levy a tax on the gain made in the transaction.

In *Segall v. Commissioner*³⁵, the Board held that the transfer by one corporation of its assets to a second corporation for cash and debenture notes was a reorganization and no taxable income resulted.

³²89 F. 2d 458, cert. den. 302 U. S. 79.

³³33 B. T. A. 147, (Oct. 3, 1935), 86 F. 2d 776, (Dec. 8, 1936) cert. den. 300 U. S. 683 on petition of taxpayer.

³⁴35 B. T. A. 646 (Mar. 11, 1937).

³⁵38 B. T. A. 43, (July 12, 1938).

In *Commissioner v. Freund*³⁶, the court held that an exchange of stock in one corporation for cash and mortgage bonds of another corporation came within the reorganization provisions, overruling the contention of the Commissioner, and the Government did not appeal.

In *Commissioner v. Kolb*³⁷, the taxpayer exchanged stock and bonds in one corporation for stock in another, and the court held against the Commissioner that this was a reorganization, and the Government did not appeal.

In *White v. United States*³⁸, the holders of stock in several corporations that were merged into another corporation received for their stock bonds of the latter corporation. The Court of Claims held this was a non-taxable reorganization, and the United States has not appealed.

In *Tyng v. Commissioner*³⁹, the owners of stock in one corporation transferred the same to another corporation for cash and bonds and both the Board of Tax Appeals and the Circuit Court of Appeals held that this was a non-taxable reorganization. Involved in the same transaction was William Buchsbaum, whose case was decided in the same opinions. At last the Government appealed in this type of case, but it is significant that the Govern-

³⁶98 F. 2d 201 (June 22, 1938).

³⁷100 F. 2d 920 (Nov. 30, 1938).

³⁸22 F. Supp. 821 (Apr. 4, 1938).

³⁹36 B. T. A. 21, 106 F. 2d 55.

ment's applications for *certiorari* in these cases were filed with this Court only on November 16, 1939 (causes Nos. 537 and 538) after the petition for *certiorari* in this *LeTulle* case had been granted and it appeared there was the possibility of this Court acting on this question.

The unanimous acceptance by all the courts of the proposition that no stock need be involved in such reorganizations is well summarized by Justice Hand in the *Tyng* case, *supra*, as follows:

"Five different Circuit Courts of Appeal, besides our own, and the Court of Claims as well, have decided that the receipt of 'securities' results in the retention of a continuity of interest necessary for a reorganization. We reached this conclusion in *Watts v. Commissioner*, 2 Cir., 75 F. (2) 981, afterwards affirmed by the Supreme Court sub nomine *Helvering v. Watts*, *supra*. The following decisions are to the same effect: *Scotfield v. LeTulle*, 5 Cir., 103 F. 2d. 20, 22; *Commissioner v. Freund*, 3 Cir., 98 F. 2d. 201, 205; *Commissioner v. Newberry L. and C. Co.*, 6 Cir., 94 F. 2d. 447, 449; *Commissioner v. Kitselman*, 7 Cir. 89 F. 2d. 458, 460; *Burnham v. Commissioner*, 7 Cir., 86 F. 2d. 776; *certiorari* denied 300 U. S. 683, 57 S. Ct. 753, 81 L. Ed. 886; *Lilienthal v. Commissioner*, 9 Cir., 80 F. 2d. 411; *White v. United States, Ct. Cls.*, 22 F. Supp. 821; 829."

In this case we have the plain and explicit regulations of the Treasury Department under the Revenue Acts of 1921, 1924, 1926, 1928 and 1932 that where a corporation transfers its properties for bonds of another corporation, this is a reorgani-

zation. While these regulations were in effect, Congress re-enacted the same identical provisions concerning reorganizations in the 1921, 1924, 1926, 1928 and 1932 Acts. Under the well recognized principles of statutory construction, Congress adopted these regulatory constructions of its statutes.

Mr. Justice Stone in the *Murphy Oil Company case*⁴⁰ states the rule:

"The method of computation provided by the amended regulation must be taken to have received the approval of Congress, for, as already noted, the provisions of Article 215 (a), as amended, have been continued in the Treasury Regulations since 1926 and those of Section 234 (a) (9) of the Revenue Act of 1918 have been reenacted without substantial change in the Revenue Acts of 1928 and 1932."

Mr. Justice Stone in *United States v. Dakota-Montana Oil Co.*⁴¹, stated:

"Thus the Acts of 1918, 1921 and 1924 were consistently construed by the regulations to permit a depletion, but not a depreciation, allowance for the costs of development work and drilling, which were treated for this purpose either as a part of the cost or an addition to the discovery value of the oil in the ground. The administrative construction must be deemed to have received legislative approval by the reenactment of the statutory provision, without material change. *Murphy Oil Co. v.*

⁴⁰*Murphy Oil Co. v. Burnet*, 287 U. S. 299, 307.

⁴¹288 U. S. 459, 466.

Burnet, 287 U. S. 299; *Brewster v. Gage*, 280 U. S. 327, 337."

Mr. Justice Cardozo reiterated the rule⁴²:

"This regulation was in substance readopted in the regulations already referred to under the Act of 1921. There are verbal variations, but not of such a nature as to suggest a change of meaning. The like is true of a Treasury Decision issued under the Revenue Act of 1926 (44 Stat. 9; T. D. 3843). All these regulations have had the tacit assent and confirmation of the lawmakers. Successive revenue statutes have been enacted without substantial change in the applicable sections. Congress seemingly has been satisfied with the Decisions of the Treasury and with the interpretation of its own meaning implicit in them. *National Lead Co. v. United States*, 252 U. S. 140, 146; *McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488, 492, 493; *Costanzo v. Tillinghast*, 287 U. S. 341, 345; *Norwegian Nitrogen Co. v. United States*, 288 U. S. 294, 315."

The Majority of this Court, speaking through Mr. Justice Stone in a very recent case⁴³ involving a situation exactly parallel to that in this case applied the rule as follows:

"This regulation is a clear recognition that Sections 115 and 101, when read with the other sections of the Act, are interdependent and require stockholders' gains upon liquidation to be taxed as are the corresponding gains on sales of property. The regulation, in identical

⁴²*Zellerbach Paper Co. v. Helvering*, 293 U. S. 172, 179.

⁴³*White v. United States*, 305 U. S. 281, 290.

form, first appeared in Article 1545 of Regulations 65 and 69, applicable to Sections 201 (c) and 208 of the Revenue Acts of 1924 and 1926, corresponding to Sections 115 (c) and 101 of the 1928 Act, and was continued in Article 625 of Regulations 77 with relation to the corresponding Sections, 115 (c) and 101, of the 1932 Act.

"The repeated reenactment of Sections 101 and 115 (c), as they appear in the Revenue Acts of 1924, 1928, and 1932, is upon accepted principles a Congressional adoption of the regulation as correctly interpreting those sections and is Congressional recognition that Sections 101 and 115 (c) are to be read together in order to ascertain the method by which gains and losses upon liquidation are to be taxed."

We respectfully submit that this Honorable Court erred in writing into the statute the continuing "proprietary interest" requirement, and the transfer of the properties from the Irrigation Company to the Water Company for long term bonds was a tax free reorganization.

II.

The question as to whether the transfer of the properties for bonds was a tax free reorganization was not properly before this Court.

The only issue made between the parties in the District Court and the Circuit Court of Appeals was whether the transfer of the properties by the Irrigation Company to the Water Company for long term bonds was a tax free reorganization. That

issue was determined against the respondent and he did not petition for a writ of *certiorari*.

The Circuit Court of Appeals then held⁴⁴ that, as to part of the properties only, they could not be considered as having been transferred to the Irrigation Company but should be treated as sold directly by petitioner to the Water Company and reversed the case as to those particular properties.

The Circuit Court of Appeals decided the *issue* of reorganization against the respondent, but yet that *issue* has now been decided by this Court in favor of the respondent without any appeal on his part. While it is true that a non-appealing respondent may urge different reasons from those of the court below on which he sustained the judgment, yet he may not disturb that judgment and the holding of the court, as Mr. Justice Brandeis said in the *Pfeiffer case*⁴⁵:

"While a decision below may be sustained, without cross-appeal, although it was rested upon a wrong ground, see *Helvering v. Gowran*, *supra*, an appellee cannot without a cross-appeal attack a judgment entered below."

That is exactly what the respondent in this case has done, attacked the holding of the Circuit Court of Appeals that there was a tax free reorganization.

Under the record as the case now stands, it would

⁴⁴Record, p. 215.

⁴⁵*Helvering v. Pfeiffer*, 302 U. S. 247.

go back to the District Court with the anomalous situation of the District Court being directed to treat the transfer by the Irrigation Company to the Water Company of part of the properties as a tax free reorganization and to treat the same transfer of the other properties as not a tax free reorganization.

It seems to us that where the definite and square issue has been determined by the court below against the respondent on the reorganization question, then this Court should pass only upon the question as to whether or not the petitioner's so-called individual properties should be included in the reorganization. In other words, if the Circuit Court of Appeals was in error, as we submit it was, in its holding as to these individual properties, then, the issue as to the reorganization having been decided against the respondent, the judgment of the District Court must be affirmed.

III.

The Circuit Court of Appeals erred in reversing the judgment of the District Court.

We here refer to, as if fully set out, all of the statements and arguments presented in our petition and briefs as to why the Circuit Court of Appeals erred. We will not repeat them as this Honorable Court has not discussed them in any way in its opinion.

Repeatedly in the respondent's brief and in the oral submission of this case it was stated that there

was no evidence in the record that petitioner's individual properties had been conveyed to the Irrigation Company. Also the Circuit Court of Appeals in its opinion states⁴⁶:

"On Nov. 7, 1931, a meeting of the stockholders of the Irrigation Company was held at which the capital stock of the Company was increased from \$100,000 to \$266,000. The entire increase was thereupon subscribed for by LeTulle, and paid for in property conveyed to the Company at a price of \$166,000. The stockholders' meeting then ratified the contract of Nov. 4, 1931, and authorized the conveyance of all its properties and business accordingly. The evidence thus plainly shows that a large part of the property conveyed under the contract of Nov. 4, 1931, was not at that date owned by the Irrigation Company but by LeTulle, and that he conveyed it to his Company by the device above stated in order to transfer it to the purchaser along with the property of the Irrigation Company."

From that statement it would *seem* that the Irrigation Company on November 4, 1931, owned \$100,000 of property and Mr. Le Tulle by the so-called "device" passed into the Company \$166,000 of additional property or, in other words, the so-called individual properties amounted to approximately one and two-thirds times the other properties owned by the Irrigation Company. We cannot help but feel that this seeming large excess of the so-called individual properties over the Company's properties consciously or unconsciously had a material

⁴⁶Record, p. 215.

effect in the decision of this case by this Court and the Circuit Court of Appeals.

We realize that the record as printed does not show the facts in reference to this, but we quote below from the original letters from the Government addressed to Mr. and Mrs. LeTulle which were offered and admitted in evidence on the trial of this case.

As will be seen from the record⁴⁷, these letters from the Government were introduced and admitted in evidence, but they were not included in the printed record as no controversy of this nature had arisen at the time the appeal was taken. The record shows at the bottom of page 49 that the commissioner conceded that the cost to the Irrigation Company of the assets that it transferred to the Water Company was at least \$398,875.96. The facts were that the \$166,000.00 of stock increase on November 4, 1931, was paid by petitioner as follows:

Cancellation of account payable to him by the Irrigation Company.....	\$57,578.04
Notes receivable transferred by him to the Company.....	33,421.96
Canals, etc.	75,000.00
Total	\$166,000.00

In the determination of the individual taxes of Mr. and Mrs. LeTulle there was a controversy between petitioner and the Government as to the cost to him of the 1,660 shares. The Government contended that the amount owing by the Irrigation

⁴⁷Record, pp. 48, 51.

Company to him was \$36,462.09 instead of \$57,578.04 and therefore the total cost to him of the stock was \$129,537.91.

In the letter of January 5, 1934, from the Treasury Department addressed to the petitioner, which was plaintiff's Exhibit No. 17, copy of which the Government has in its file, this matter of the payment of the 1,660 shares is set forth in detail as follows:

"Cost to V. L. LeTulle of 1,660 shares of stock of Gulf Coast Irrigation Company:

"Increase of capital stock of Gulf Coast Irrigation Company issued to V. L. LeTulle for the following:

Account Payable (per books of Gulf Coast Irrigation Co.)	\$57,578.04
Notes Receivable	33,421.96
Canals, etc.	75,000.00

Total	\$166,000.00
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"It has been found, however, that the account payable of \$57,578.04 was overstated by an amount of \$36,462.09. There follows a computation showing such difference:"

(There then followed a detailed computation unnecessary to repeat here and then the letter stated the final determination of that cost as follows:)

"Cost of 1,660 shares of stock as corrected:

Account Payable as corrected from Gulf Coast Irrigation Co.	\$21,115.95
Notes Receivable	33,421.96
Canals, etc.	75,000.00

Total cost	\$129,537.91"
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In the letter from the Treasury Department of May 14, 1934, addressed to Mr. V. L. LeTulle, which was plaintiff's Exhibit No. 11, the Government in computing the cost to the Irrigation Company of the LeTulle properties carried this cost at \$75,000.00 on the following line:

"Right of way, etc.....\$75,000.00"

In the letter from the Treasury Department of May 19, 1934, to Mr. LeTulle, which was plaintiff's Exhibit No. 15, the cost of the 1,660 shares is set forth as follows:

"Cost 1,660 shares.....\$129,537.91"

In this case plaintiff contended, as shown by his petition in the record at page 19, that the 1,660 shares cost the full \$166,000.00 as follows:

150 Shares	\$ 15,000.00
1510 Shares	151,000.00

The District Court, however, in its findings of fact⁴⁰ found with the Government that the 1,660 shares cost only \$129,537.91.

The facts set forth in the above referred to exhibits are uncontradicted and, if this issue had been in this case at any time, those exhibits would have been included in the record. The issue was never at any time raised. For example, the respondent, in his requests for special findings of fact and conclusions of law⁴¹, made no request whatsoever that the District Court make any finding in reference to these individual properties.

⁴⁰Record, p. 147.

⁴¹Record, pp. 140-144.

As above shown, the cost to the Irrigation Company of all the properties transferred to the Water Company was \$398,875.96, the cost to it of these individual properties being \$75,000.00. On the basis of comparative cost, these individual properties amounted to only slightly more than 18 per cent of the total properties transferred. In fact, as could have been shown on the trial of this case if this issue had been raised, these so-called individual properties on a valuation basis at the time of the transaction were at the most not more than 10 per cent of the total properties. The Irrigation Company had been in existence for many years and had an extensive irrigation system with expensive pumping plants, all of which were located on its own properties. These individual properties consisted of rights of way for canals which were merely extensions of the existing system of the Irrigation Company, and were utterly valueless without being connected with the Irrigation Company's properties. They had been operated right along with the Company's properties without any distinction as to their legal ownership, and, being worthless unless connected with the main irrigation system, they were simply included in the transaction.

Conclusion.

We respectfully request this Honorable Court to grant this petition for rehearing and reverse the judgment of the Circuit Court of Appeals and affirm that of the District Court. If this Honorable

Court has any doubt as to the correctness of our position, then we pray the opportunity for a reargument of the case.

In connection with our request for reargument, we respectfully call the attention of this Court to certain facts. In the District Court and Circuit Court of Appeals the entire argument on both sides was devoted to the one question as to whether the transfer of the properties for bonds was a tax free reorganization, and both the District Court and Circuit Court of Appeals held with the taxpayer on that point. The Circuit Court of Appeals then reversed the case on a point that had never been mentioned or argued in that court. Upon the presentation of the case in this Court, practically the entire argument was devoted to a consideration as to whether the Circuit Court of Appeals' action in reversing the case was correct with only incidental reference to the point upon which this Court has decided the case, contrary to the lower courts. The result has been that the petitioner lost in the Circuit Court of Appeals on a point that was never argued, and now in this Court on a point decided in its favor by the lower courts and only incidentally touched upon by each side in the argument before this Honorable Court.

Respectfully submitted,

W. E. DAVANT,
HOMER L. BRUCE,

Attorneys for Petitioner.

CERTIFICATE OF COUNSEL

I, Homer L. Bruce, attorney for the above named petitioner, do hereby certify that the foregoing petition for rehearing of this cause is presented in good faith and not for delay.

HOMER L. BRUCE,
Attorney for Petitioner.

APPENDIX NO. 1

REVENUE ACT OF 1921

(42 Stat., C. 136, p. 227, 229, 230)

BASIS FOR DETERMINING GAIN OR LOSS.

SEC. 202. * * *

(c) For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value;

but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—

* * *

(2) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization," as used in this paragraph, includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, (however effected); or

(3) When (A) a person transfers any property, real, personal or mixed, to a corporation, and immediately after the transfer is in control of such corporation, or

(B) two or more persons transfer any such property to a corporation, and immediately after the transfer are in control of such corporation, and the amounts of stock, securities, or both, received by such persons are in substantially the same proportion as their interests in the property before such transfer.

For the purposes of this paragraph, a person is, or two or more persons are, "in control" of a corporation when owning at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

APPENDIX NO. 2

REGULATIONS 62

UNDER

REVENUE ACT OF 1921

ART. 1566. *Exchange of property which results in no gain or loss.*—Where property is exchanged for other property, even if the property received in exchange has a readily realizable market value, no gain or loss is recognized:

* * * * *

(b) When in the reorganization of one or more corporations a person receives in place of any stock or securities owned by him, stock or securities in a corporation a party to or resulting from such reorganization. The word "reorganization" as used in this paragraph includes a merger or consolidation (including the acquisition by one corporation of at least a majority of the outstanding voting

stock and at least a majority of the total number of outstanding shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation, however effected. *Under this paragraph it makes no difference whether the stock or securities received are or are not of a like kind or class.* So long as the property received in the reorganization consists of stock or securities within the usual meaning and acceptance of these terms, no gain or loss is recognized. *Where two or more corporations unite their properties, by either (1) the dissolution of corporation B and the sale of its assets to corporation A, or (2) the sale of its property by B to A, or (3) the sale of the stock of B to A, or (4) the merger of B into A, or (5) the consolidation of A and B, or (6) the acquisition by A of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of B or of substantially all of the properties of B, no taxable income is received from the transaction by A or B, or by the stockholders of either corporation A or corporation B, provided the sole consideration received by the stockholders is stock OR securities of corporations A or B or any corporation a party to or resulting from the reorganization.* Where in connection with an internal adjustment of the affairs of a corporation, either by recapitalization or a change in identity, form, or domicile (however effected), a person receives in place of the stock or securities owned by him new stock or secur-

ities of the corporation, no gain or loss is realized. In this connection, see Article 1568.

APPENDIX NO. 3

REVENUE ACT OF 1924

(43 Stat., C. 234, p. 253, 256-258)

RECOGNITION OF GAIN OR LOSS FROM SALES AND EXCHANGES

SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under Section 202, shall be recognized, except as hereinafter provided in this section.

(b) * * *

(2) No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * *

(h) As used in this section and Sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the

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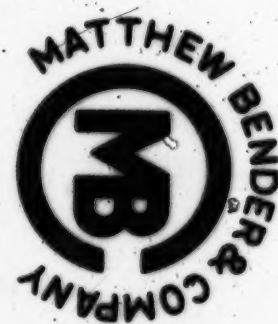
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voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a party of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

APPENDIX NO. 4

REGULATIONS 65

UNDER

REVENUE ACT OF 1924

ART. 1574. *Exchanges in connection with corporate reorganization.*—Since corporate reorganizations which result only in a change in form and which do not substantially affect the property interests either of the shareholders or of the corporations may be required or may be made desirable by business conditions, State laws, or other causes,

the statute provides that no gain or loss shall be recognized to the shareholders from the exchange of stock made in connection with the reorganization nor to the corporations from the exchange of property made in connection with the reorganization. *If two or more corporations reorganize, for example, by either* (1) the dissolution of corporation B and the sale of its assets to corporation A, or (2) *the sale of its property by B to A*, or (3) the sale of the stock of B to A, or (4) the merger of B into A, or (5) the consolidation of A and B, or (6) *the acquisition by A of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of B or of substantially all of the properties of B*, or (7) the transfer by A of all or a part of its assets to B where immediately after the transfer A or its shareholders are in control of B, *then no taxable income is received from the transaction by corporation A or B if the sole consideration for the transfer of the assets is stock OR securities of corporation A or B*; and no taxable income is received from the transaction by the shareholders of either corporation A or corporation B if the sole consideration received by the shareholders is stock or securities of corporation A or B. Furthermore, if the reorganization is accomplished by the transfer by corporation A of a portion of its assets to corporation B in exchange for the stock of corporation B and corporation A distributes as a dividend to its shareholders the stock of corporation B, no taxable income is real-

ized by the shareholders from the receipt of such dividends. (See Art. 1576.)

In conformity with the principle of ignoring for tax purposes those reorganizations which result merely in a change in form, the statute provides further that the stock received by the shareholders in connection with the reorganization shall have the same basis for the purpose of determining gain or loss from its subsequent sale as the stock surrendered by them and that the assets acquired by a corporation a party to the reorganization shall have the same basis for the purposes of depreciation, depletion, and determination of gain or loss from subsequent sale as they had in the hands of the corporation from which they were acquired. (See Arts. 1596-1598.) The exchanges made by both the shareholders and the corporations in connection with a reorganization are ignored and both are treated thereafter as if the reorganization had not occurred.

Adequate provision is made in the statute for cases in which income is actually realized by the shareholders in connection with the reorganization through the receipt of cash or property other than the stock of a corporation a party to the reorganization. (See Art. 1575.) In such cases the gain to the shareholder is recognized and taxed, but in an amount not exceeding the amount of the money or the other property received in connection with the reorganization. If the money so distributed in connection with the reorganization has the effect of the distribution of a taxable dividend, such gain is

taxed not as a capital gain but as an ordinary dividend subject to the surtax rates. While placing no obstacle in the way of genuine reorganizations, the statute does not allow the use of reorganizations to avoid the tax.

Records in substantial form, showing the basis of the stock or property exchanged, and the amount of property or money received in exchange, must be kept to enable the determination of gain or loss from a subsequent disposition of the stock or property received or exchanged.

ART. 1577. DEFINITIONS.—The term "reorganization," as used in Sections 201, 203, and 204 of the statute means (1) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation); or (2) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (3) a recapitalization, or (4) a mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in Sections 201, 203, and 204 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number

of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation within the meaning of Section 203, when owning (1) at least 80 per cent of the voting stock, and (2) at least 80 per cent of the total number of shares of all other classes of stock of the corporation.

As used in this section, as well as in other provisions of the statute, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of Article 1572 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization, or in other corporations parties to the reorganization, are received in exchange.

APPENDIX NO. 5

REVENUE ACT OF 1926

(44 Stat., C. 27, p. 9, 12-14)

RECOGNITION OF GAIN OR LOSS FROM SALES AND EXCHANGES

SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, de-

terminated under Section 202, shall be recognized, except as hereinafter provided in this section.

(b) * * *

(2) No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * *

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization"

includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

APPENDIX NO. 6

REGULATIONS 69 UNDER REVENUE ACT OF 1926

ART. 1574. *Exchanges in connection with corporate reorganizations.*—Since corporate reorganizations which result only in a change in form and which do not substantially affect the property interests, either of the shareholders or of the corporations, may be required or may be made desirable by business conditions, State laws, or other causes, the statute provides that no gain or loss shall be recognized if, in pursuance of a plan of reorganization, stock or securities in a corporation a party to a reorganization are exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization, or if, in pursuance of a reorganization plan, a corporation a party to a reorganization exchanges property solely for stock or securities in another corporation a party to the reorganization. *If two or more corporations reorganize, for example by—*

(1) The dissolution of corporation B and the sale of its assets to corporation A,

(2) *The sale of its property by B to A,*

(3) The sale of the stock of B to A,

(4) The merger of B into A,

(5) The consolidation of A and B,

(6) *The acquisition by A of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of B or of substantially all of the properties of B, or*

(7) The transfer by A of all or a part of its assets to B where immediately after the transfer A or its shareholders are in control of B,

then no taxable income is received from the transaction by corporation A or B if the sole consideration for the transfer of the assets is stock OR securities of corporation A or B; and no taxable income is received from the transaction by the shareholders of either corporation A or corporation B if the sole consideration received by the shareholders is stock or securities of corporation A or B.

Furthermore, if the reorganization is accomplished by the transfer by corporation A of a portion of its assets to corporation B in exchange for the stock of corporation B, and corporation A distributes to its shareholders the stock of corporation B, no taxable income is realized by the shareholders from the receipt of such stock. (See Art. 1576.)

In conformity with the principle of ignoring for tax purposes those reorganizations which result merely in a change in form, the statute provides

further that the stock received by the shareholders in connection with the reorganization shall have the same basis for the purpose of determining gain or loss from its subsequent sale as the stock surrendered by them, and that the assets acquired by a corporation a party to the reorganization shall have the same basis for determining depletion, exhaustion, wear and tear, obsolescence, and gain or loss from subsequent sale as they had in the hands of the corporation from which they were acquired. (See Arts. 1596-1598.)

Adequate provision is made in the statute for cases in which income is actually realized by the shareholders in connection with the reorganization through the receipt of cash or property other than the stock of a corporation a party to the reorganization. (See Art. 1575.) While placing no obstacle in the way of genuine reorganizations, the statute does not allow the use of reorganizations to avoid the tax.

Records in substantial form, showing the basis of the stock or property exchanged, and the amount of property or money received in exchange, must be kept to enable the determination of gain or loss from a subsequent disposition of the stock or property received or exchanged.

ART. 1577. DEFINITIONS.—The term "reorganization," as used in Sections 201, 203, and 204 means—

(1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of

the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation).

(2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in Sections 201, 203, and 204 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of Section 203, when owning—

(1) At least 80 per cent of the voting stock, and

(2) At least 80 per cent of the total number of shares of all other classes of stock of the corporation.

As used in Section 203, as well as in other provisions of the statute, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For

example, the provisions of Article 1574 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

APPENDIX NO. 7

REVENUE ACT OF 1928

(45 Stat., C. 852, p. 791, 816-818)

SECTION 112. RECOGNITION OF GAIN OR LOSS

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of gain or loss, determined under Section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * *

(3) **STOCK FOR STOCK ON REORGANIZATION.**—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) **SAME—GAIN OF CORPORATION.**—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) **TRANSFER TO CORPORATION CONTROLLED**

BY TRANSFEROR.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsec-

tion (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * *

(i) *Definition of reorganization.*—As used in this section and Sections 113 and 115—

(1) The term “reorganization” means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders of both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of control.*—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

APPENDIX NO. 8

REGULATIONS 74

UNDER

REVENUE ACT OF 1928

ART. 574. *Exchanges in Connection With Corporate Reorganizations.*—The Act provides that no gain or loss shall be recognized if, in pursuance of a plan of reorganization, stock or securities in a corporation a party to a reorganization are exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization, or if, in pursuance of a reorganization plan, a corporation a party to a reorganization exchanges property solely for stock or securities in another corporation a party to the reorganization. *If two or more corporations reorganize, for example, by—*

(1) The merger of the X Corporation into the Y Corporation,

(2) The consolidation of the X Corporation and the Z Corporation into the Y Corporation, a new corporation,

(3) *The acquisition by the Y Corporation of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of the X Corporation or of substantially all of the properties of the X Corporation, or*

(4) The transfer by the X Corporation of a part of its assets to the Y Corporation where immediately after the transfer the X Corporation or its shareholders or both are in control of the Y Corporation—*then no taxable income is received from the transaction by the X Corporation or the Z Corporation if the sole consideration received by the corporation is stock OR securities of the Y Corporation; and no taxable income is received from the transaction by the shareholders of either the X Corporation or the Z Corporation if the sole consideration received by the shareholders is stock or securities of the Y Corporation.*

If a reorganization is accomplished by the transfer by the X Corporation of a part of its assets to the Y Corporation in exchange for the stock of the Y Corporation and the X Corporation distributes to its shareholders the stock of the Y Corporation, no gain to the shareholders from the receipt of such stock is recognized. (See Article 576.)

Provision is made in the Act for cases in which

gain to the shareholders is recognized, in connection with a reorganization, through the receipt of cash or property other than the stock of a corporation a party to the reorganization. (See Article 575.)

Records in substantial form, showing the basis of the stock or property exchanged and the amount of property or money received in exchange, must be kept to enable the determination of gain or loss from a subsequent disposition of the stock or property received in exchange.

ART. 577. *Definitions.*—The term “reorganization,” as used in Sections 112, 113, and 115 means—

(1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term “a party to a reorganization” as used in Sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting

stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of Section 112, when owning—

- (1) At least 80 per cent of the voting stock, and
- (2) At least 80 per cent of the total number of shares of all other classes of stock of the corporation.

As used in Section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of Article 574 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

APPENDIX NO. 9

REVENUE ACT OF 1932

(47 Stat., c. 209, p. 169, 196-198)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss,

determined under Section 111, shall be recognized, except as hereinafter provided in this section.

(b) **EXCHANGES SOLELY IN KIND.—**

* * * * *

(3) **STOCK FOR STOCK ON REORGANIZATION.—**No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) **SAME—GAIN OF CORPORATION.—**No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(i) **DEFINITION OF REORGANIZATION.—**As used in this section and Sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

APPENDIX NO. 10.

REGULATIONS 77 UNDER REVENUE ACT OF 1932

ART. 574. *Exchanges in connection with corporate reorganizations.*—The Act provides that no gain or loss shall be recognized if, in pursuance of a plan of reorganization, stock or securities in a corporation a party to a reorganization are exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization, or if, in pursuance of a reorganization plan, a corporation a party to a reorganization exchanges property solely for stock or securities in another corporation a party to the reorganization. *If two or more corporations reorganize, for example, by—*

(1) The merger of the X Corporation into the Y Corporation,

(2) The consolidation of the X Corporation and the Z Corporation into the Y Corporation, a new corporation,

(3) *The acquisition by the Y Corporation of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of the X Corporation or of substantially all of the properties of the X Corporation, or*

(4) *The transfer by the X Corporation of a part of its assets to the Y Corporation where immediately after the transfer the X Corporation or its shareholders or both are in control of the Y Corporation—*

then no taxable income is received from the transaction by the X Corporation or the Z Corporation if the sole consideration received by the corporations is stock OR securities of the Y Corporation; and no taxable income is received from the transaction by the shareholders of either the X Corporation or the Z Corporation if the sole consideration received by the shareholders is stock or securities of the Y Corporation.

If a reorganization is accomplished by the transfer by the X Corporation of a part of its assets to the Y Corporation in exchange for the stock of the Y Corporation and the X Corporation distributes to its shareholders the stock of the Y Corporation, no gain to the shareholders from the receipt of such stock is recognized. (See Art. 576.)

Provision is made in the Act for cases in which gain to the shareholders is recognized, in connection with a reorganization, through the receipt of cash or property other than the stock of a corporation a party to the reorganization. (See Art. 575.)

Records in substantial form, showing the basis of the stock or property exchanged and the amount of property or money received in exchange, must be kept to enable the determination of gain or loss from a subsequent disposition of the stock or property received in exchange.

ART. 577. *Definitions.*—The term “reorganization,” as used in Sections 112, 113, and 115 means—

(1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term “a party to a reorganization” as used in Sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of Section 112, when owning—

- (1) At least 80 per cent of the voting stock, and
- (2) At least 80 per cent of the total number of shares of all other classes of stock of the corporation.

As used in Section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of Article 574 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

APPENDIX NO. 11

REVENUE ACT OF 1934

(48 Stat., C. 277, p. 680, 704-705)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) GENERAL RULE.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under Section 111, shall be recognized, except as hereinafter provided in this section.

(b) EXCHANGES SOLELY IN KIND.—

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or

securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) **SAME—GAIN OF CORPORATION.**—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * *

(g) **DEFINITION OF REORGANIZATION.**—As used in this section and Section 113—

(1) The term “reorganization” means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change in identity, form, or place of organization, however effected.

(2) The term “a party to a reorganization” includes a corporation resulting from a reorganization and includes both corporations in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

p. 4

SUPREME COURT OF THE UNITED STATES.

No. 63.—OCTOBER TERM, 1939.

V. L. LeTulle, Petitioner,
vs.
Frank Scofield, United States Collector
of Internal Revenue for the First
District of Texas.

On Writ of Certiorari to
the United States Circuit
Court of Appeals for the
Fifth Circuit.

[January 2, 1940.]

Mr. Justice ROBERTS delivered the opinion of the Court.

We took this case because the petition for certiorari alleged that the Circuit Court of Appeals had based its decision on a point not presented or argued by the litigants, which the petitioner had never had an opportunity to meet by the production of evidence.

The Gulf Coast Irrigation Company was the owner of irrigation properties. Petitioner was its sole stockholder. He personally owned certain lands and other irrigation properties. November 4, 1931, the Irrigation Company, the Gulf Coast Water Company, and the petitioner, entered into an agreement which recited that the petitioner owned all of the stock of the Irrigation Company; described the company's properties, and stated that, prior to conveyance to be made pursuant to the contract, the Irrigation Company would be the owner of certain other lands and irrigation properties. These other lands and properties were those which the petitioner individually owned. The contract called for a conveyance of all the properties owned, and to be owned, by the Irrigation Company for \$50,000 in cash and \$750,000 in bonds of the Water Company, payable serially over the period January 1, 1933, to January 1, 1944. The petitioner joined in this agreement as a guarantor of the title of the Irrigation Company and for the purpose of covenanting that he would not personally enter into the irrigation business within a fixed area during a specified period after the execution of the contract. Three days later, at a special meeting of stockholders of the Irrigation Company, the proposed reorganization was approved, the minutes stating that the taxpayer, "desiring also to reorganize his interest in the properties," had consented to be a party to the re-

organization. The capital stock of the Irrigation Company was increased and thereupon the taxpayer subscribed for the new stock and paid for it by conveyance of his individual properties.

The contract between the two corporations was carried out November 18, with the result that the Water Company became owner of all the properties then owned by the Irrigation Company including the property theretofore owned by the petitioner individually. Subsequently all of its assets, including the bonds received from the Water Company, were distributed to the petitioner. The company was then dissolved. The petitioner and his wife filed a tax return as members of a community in which they reported no gain as a result of the receipt of the liquidating dividend from the Irrigation Company. The latter reported no gain for the taxable year in virtue of its receipt of bonds and cash from the Water Company. The Commissioner of Internal Revenue assessed additional taxes against the community, as individual taxpayers, by reason of the receipt of the liquidating dividend, and against the petitioner as transferee of the Irrigation Company's assets in virtue of the gain realized by the company on the sale of its property. The tax was paid and claims for refund were filed. Petitioner's wife having died he brought suit individually and as her executr and representative in the community property against the respondent to recover the amount of the additional taxes so assessed. He alleged that the transaction constituted a tax-exempt reorganization as defined by the Revenue Act.¹ The respondent traversed the allegations of the complaints and the causes were consolidated and tried by the District Court without a jury. The respondent's contention that the transaction amounted merely to a sale of assets by the petitioner and the Irrigation Company and did not fall within the statutory definition of a tax-free reorganization was overruled by the District Court and judgment was entered for the petitioner.

The respondent appealed, asserting error on the part of the District Court in matters not now material and also assigning as error the court's holding that the transaction constituted a nontaxable reorganization.

The Circuit Court of Appeals concluded that, as the Water Company acquired substantially all the properties of the Irrigation Company, there was a merger of the latter within the literal

¹ Sec. 112(i) of the Revenue Act of 1928, c. 852, 45 Stat. 791, 818.

language of the statute, but held that, in the light of the construction this Court has put upon the statute, the transaction would not be a reorganization unless the transferor retained a definite and substantial interest in the affairs of the transferee. It thought this requirement was satisfied by the taking of the bonds of the Water company, and, therefore, agreed with the District Court that a reorganization had been consummated. It added, however, "We had a reason for reversing the judgment which has not been argued." Adverting to the fact that the transfer of the petitioner's individual properties to the Irrigation Company was for the purpose of including them in the latter's assets to be transferred in the proposed reorganization, the court said the statute did not extend to the reorganization of an individual's business or affairs, and the transaction was a reorganization within the meaning of the Revenue Act as respects the corporation's assets owned on November 4, 1931, but not as respects the petitioner's individual properties included in the sale. It concluded: "Only so much of the consideration as represents the price of the properties and business of the Irrigation Company is entitled to be protected from taxation as arising from a reorganization. It does not appear what the proper apportionment is. The burden was upon LeTulle to show not only that he had been illegally taxed, but how much of what was collected from him was illegal. The latter he did not do. The evidence does not support the judgment for the full amount paid by him. It is accordingly reversed, that further proceedings may be had consistent herewith."²

The petitioner sought certiorari asserting that the Circuit Court of Appeals had departed from the usual and accepted course of judicial proceedings by deciding the cause upon a ground not presented or argued and hence had deprived the petitioner of his day in court. The respondent, though he had contended below that the transaction in question did not amount to a tax-free statutory reorganization, did not file a cross petition asking for a review of that part of the judgment exempting from taxation gain to the Irrigation Company arising from the transfer of its assets owned by it prior to November 4, 1931, and the part of the liquidating dividend attributable thereto.

We find it unnecessary to consider petitioner's contention that the Circuit Court of Appeals erred in deciding the case on a ground not raised by the pleadings, not before the trial court, not suggested

or argued in the Circuit Court of Appeals, and one as to which the petitioner had never had the opportunity to present his evidence, since we are of opinion that the transaction did not amount to a reorganization and that, therefore, the petitioner cannot complain, as the judgment must be affirmed on the ground that no tax-free reorganization was effected within the meaning of the statute.

Section 112(i) provides, so far as material:

"(1) The term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation).

As the court below properly stated, the section is not to be read literally, as denominating the transfer of all the assets of one company for what amounts to a cash consideration given by the other a reorganization. We have held that where the consideration consists of cash and short term notes the transfer does not amount to a reorganization within the true meaning of the statute, but is a sale upon which gain or loss must be reckoned.³ We have said that the statute was not satisfied unless the transferor retained a substantial stake in the enterprise and such a stake was thought to be retained where a large proportion of the consideration was in common stock of the transferee,⁴ or where the transferor took cash and the entire issue of preferred stock of the transferee corporation.⁵ And, where the consideration is represented by a substantial proportion of stock, and the balance in bonds, the total consideration received is exempt from tax under Sec. 112(b)(4) and 112(g).⁶

In applying our decision in the *Pinellas* case (*supra*) the courts have generally held that receipt of long term bonds as distinguished from short term notes constitutes the retention of an interest in the purchasing corporation. There has naturally been some difficulty in classifying the securities involved in various cases.⁷

We are of opinion that the term of the obligations is not material. Where the consideration is wholly in the transferee's bonds, or part

³ *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U. S. 402.

⁴ *Helvering v. Minnesota Tea Co.*, 296 U. S. 378.

⁵ *Helvering v. Nelson*, 296 U. S. 374.

⁶ 45 Stat. 816, 818. See *Helvering v. Watts*, 296 U. S. 387.

⁷ *Worcester Salt Co. v. Commissioner*, 75 F. (2d) 251; *Lillenthal v. Commissioner*, 80 F. (2d) 411, 413; *Burnham v. Commissioner*, 86 F. (2d) 776; *Commissioner v. Kitzelman*, 89 F. (2d) 458; *Commissioner v. Freund*, 98 F. (2d) 201; *Commissioner v. Tyng*, 106 F. (2d) 55; *L. & E. Stirn v. Commissioner* (C. C. A. 2), decided Nov. 6, 1939, C. C. H. Vol. 4, 1939, ¶ 9741.

cash and part such bonds, we think it cannot be said that the transferor retains any proprietary interest in the enterprise. On the contrary, he becomes a creditor of the transferee; and we do not think that the fact referred to by the Circuit Court of Appeals, that the bonds were secured solely by the assets transferred and that, upon default, the bondholder would retake only the property sold, changes his status from that of a creditor to one having a proprietary stake, within the purview of the statute.

We conclude that the Circuit Court of Appeals was in error in holding that, as respects any of the property transferred to the Water Company, the transaction was other than a sale or exchange upon which gain or loss must be reckoned in accordance with the provisions of the revenue act dealing with the recognition of gain or loss upon a sale or exchange.

Had the respondent sought and been granted certiorari the petitioner's tax liability would, in the view we have expressed, be substantially increased over the amount found due by the Circuit Court of Appeals. Since the respondent has not drawn into question so much of the judgment as exempts from taxation gain to the Irrigation Company arising from transfer of its assets owned by it on and prior to November 4, 1931, and the part of the liquidating dividend attributable thereto, we cannot afford him relief from that portion of the judgment which was adverse to him.

A respondent or an appellee may urge any matter appearing in the record in support of a judgment,⁸ but he may not attack it even on grounds asserted in the court below, in an effort to have this Court reverse it, when he himself has not sought review of the whole judgment, or of that portion which is adverse to him.⁹

The judgment of the Circuit Court of Appeals is affirmed and the cause is remanded to the District Court with directions to proceed in accordance with the opinion and mandate of the Circuit Court of Appeals.

So ordered.

⁸ *Langnes v. Green*, 282 U. S. 531, 535-537; *Helvering v. Gowran*, 302 U. S. 238, 245; *Ticonic Bank v. Sprague*, 303 U. S. 406, 410, Note 3.

⁹ *The Stephen Morgan*, 94 U. S. 599; *Mount Pleasant v. Beckwith*, 100 U. S. 514, 527; *United States v. Blackfeather*, 155 U. S. 180, 186; *Landram v. Jordan*, 203 U. S. 56, 62; *Bothwell v. United States*, 254 U. S. 231, 233; *United States v. American Railway Express Co.*, 265 U. S. 425, 435; *Morley Construction Co. v. Maryland Casualty Co.*, 300 U. S. 185, 191.

MICRO CARD

22

TRADE MARK



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